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ECONOMY SURVEY

2024-25

Open Session - 1

14th Feb. 2025

(Supplementary Reading Resource)

By Kumar Shivang

(Faculty - GS Foundation)

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ECONOMIC SURVEY 2024-25

CHAPTER 1: STATE OF THE ECONOMY: GETTING BACK INTO THE FAST LANE

INTRODUCTION

The Indian economy has remained resilient, despite global challenges like geopolitical tensions, inflationary pressures, and trade disruptions. In FY24, India's GDP growth was estimated at 7.3%, making it the fastest-growing major economy in the world. Strong domestic demand, capital expenditure-driven growth, and stable fiscal policies have ensured steady economic performance. Structural reforms, investment-driven expansion, and regulatory easing continue to shape India's medium-term outlook.

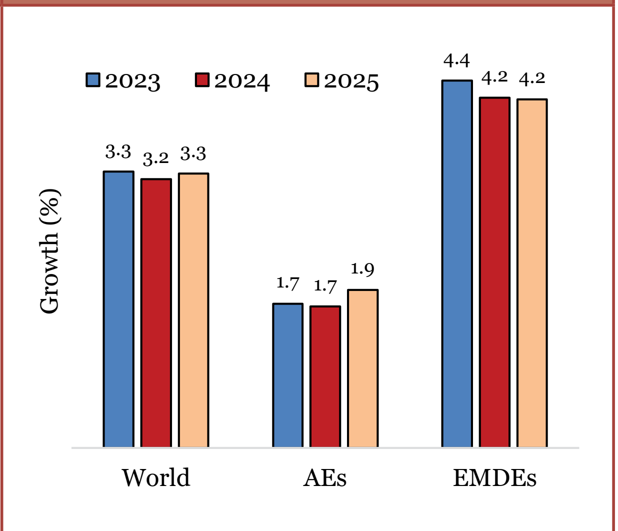
GLOBAL ECONOMIC SCENARIO

Global Growth Trends

Chart I.1: Resilient global growth trends in 2024

Source: OECD Economic Outlook, Volume 2024 Issue 2.

Chart I.2: Steady growth outlook across country groups



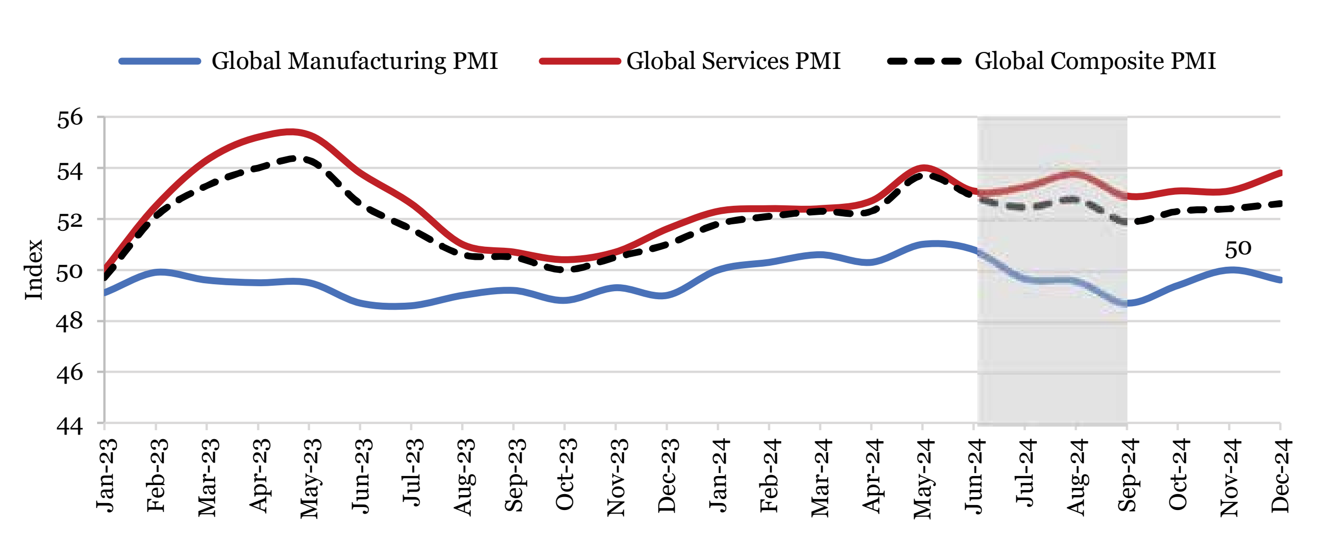
Source: IMF WEO (January 2025)
Note: AEs- Advanced Economies, EMDEs- Emerging market and developing economies

- 2024 has been an eventful year as it witnessed electoral activity with more than 50% of the global population in election mode.
- Persistent issues like Russia-Ukraine and the Israel-Hamas conflict increased regional instability.
- Cyber-attacks also became more frequent and severe.
- The global economic growth rate stabilized at 3.2% in 2024, slightly below pre-pandemic levels.

- Advanced economies (AEs) like the US, Eurozone, and Japan have faced slowdowns due to high interest rates and policy tightening.
- Emerging market economies (EMEs), particularly India, ASEAN nations, and parts of Africa, have outperformed, growing at 4.5%-5%.
- China's growth remains weak due to real estate distress and subdued domestic demand.

Steady Services Sector Growth

Chart I.5: Global manufacturing stabilises in November 2024



Source: Bloomberg

- The global composite Purchasing Managers' Index (PMI) has stayed in the expansion zone.
- The services sector continues to show strength while manufacturing PMI indicated contraction
- India reported the strongest expansion of output.
- On the global services front, the global Services PMI Business Activity Index rose to a four-month high of 53.8 in December. This signals expansion for the twenty-third consecutive month

Inflation and Interest Rate Trends

- Inflation rates across economies have trended downward steadily, approaching central bank target levels.
- Global inflation remains above long-term averages, particularly in services and energy prices.
- Disinflation seems to have slowed due to the persistence of services inflation, while core goods inflation has fallen to negligible levels.
- The US Federal Reserve and European Central Bank (ECB) have paused rate hikes, but global liquidity remains constrained.
- Global shipping route disruptions in the Red Sea, and delays at the Panama Canal have partially sustained inflationary pressures
- Emerging markets have followed a cautious monetary stance, balancing inflation control with growth support.

Chart I.8: Inflation in advanced economies

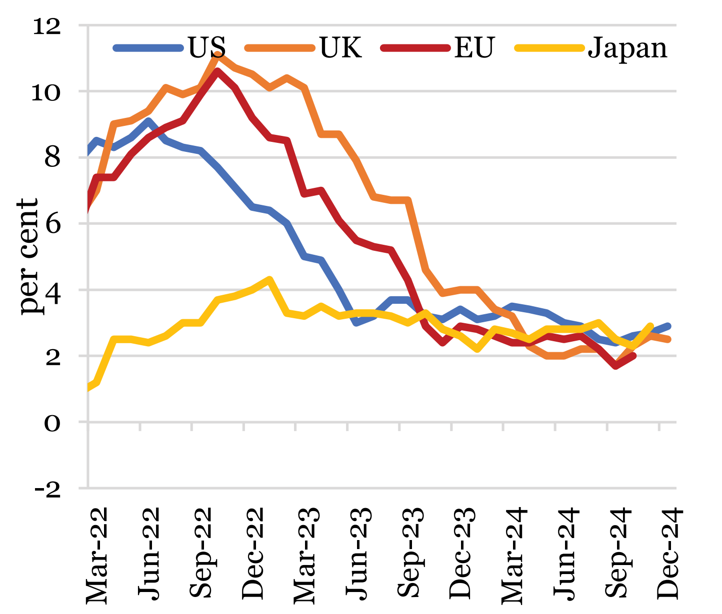
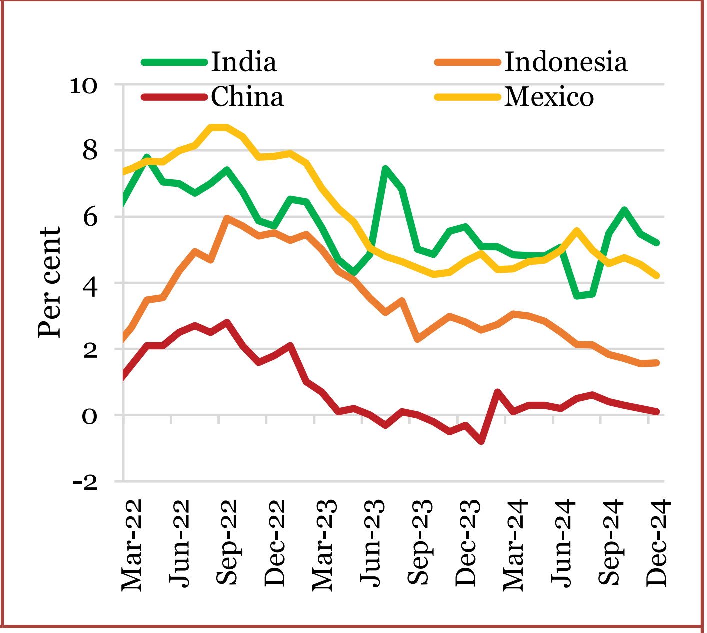


Chart I.9: Inflation in emerging market economies



Source: OECD and MoSPI

- The success in inflation control and expectations of lower borrowing costs began to reflect in the downward trajectory of sovereign bond yields of advanced economies
- India's inflation trajectory has remained stable, allowing policy flexibility for future economic expansion.

Geopolitical and Trade Disruptions

- The global trade environment has become protectionist, with rising tariff and non-tariff barriers.
- An intensification of the evolving conflicts in the Middle East, or the Russia-Ukraine conflict may disrupt global energy markets.
- The US-China rivalry, energy security concerns, and CBAM (Carbon Border Adjustment Mechanism) are reshaping global commerce.
- Tensions in the Middle East have disrupted trade through one of the critical shipping routes – the Suez Canal.
- The Geopolitical Economic Policy Uncertainty index remains elevated due to global concerns about economic policies.
- Similarly, the World Trade Uncertainty Index has risen, driven by trade tensions and policy shifts in major economies.
- India's diversified trade partnerships and resilient services sector have cushioned external risks.

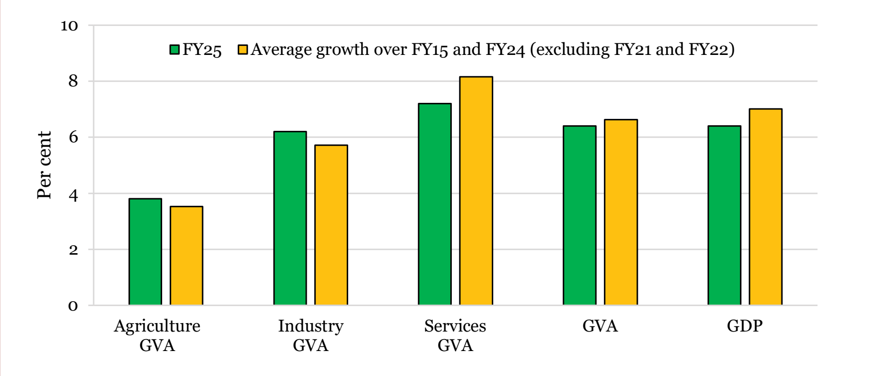
DOMESTIC ECONOMY REMAINS STEADY AMIDST GLOBAL UNCERTAINTIES

GDP Growth and Sectoral Trends

India's GDP growth for FY24 was 7.3%, outperforming major economies, driven by rebound in the rural economy

Key growth drivers include:

Chart I.20: Despite global uncertainty, India's growth remains close to decadal average (at constant prices)



- Strong domestic consumption (Private Final Consumption Expenditure - PFCE at 62% of GDP)
- Robust public and private investment (GFCF expected growth by 6.2%)
- The agricultural sector is expected to rebound
- Manufacturing expansion under PLI schemes
- Growth in the services sector is expected to remain robust

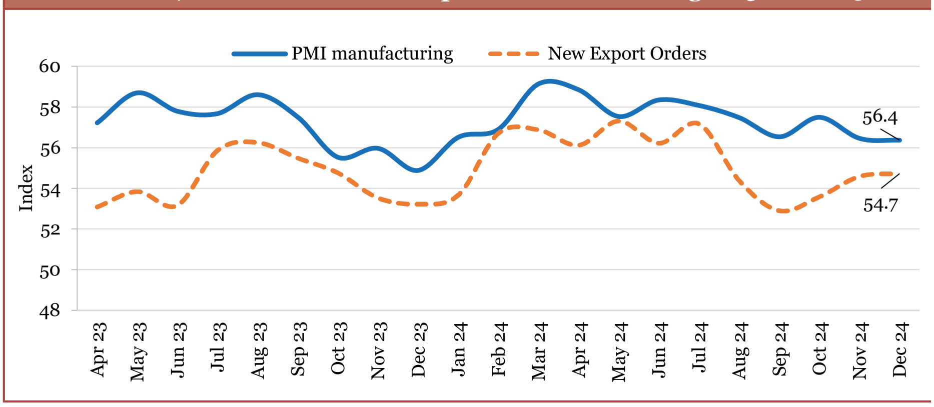
Agriculture and Rural Economy

- Agriculture growth remained stable, with record Kharif output, above-normal monsoons, and an adequate reservoir level supporting agricultural growth.
- Rural demand improved, supported by higher minimum support prices (MSP) and increased rural credit availability.
- Prospects for a good Rabi crop this year
- Improved agricultural prospects also bode well for softening food inflation pressures over the course of the year.

Industrial and Manufacturing Growth

- The industrial sector grew by 6 per cent in H1 FY25.
- Despite various challenges, India continues to register the fastest growth in manufacturing PMI

Chart I.27: Global slowdown impacted manufacturing in Q2 of FY25



Services Sector Performance

- The services sector grew at 7.2 %, with IT, financial services, and hospitality leading the expansion.
- Travel, tourism, and retail sectors saw strong recoveries, driving urban consumption.
- PMI services have been in an expansionary zone during H1 FY25, supported by growth in new orders, rise in output, improvement in sales and enhanced employment generation.

Fiscal Stability and External Sector

- Fiscal deficit reduced to 5.9% of GDP, ensuring macroeconomic stability.
- Current Account Deficit (CAD) improved, with services exports and remittances offsetting merchandise trade imbalances.
- Forex reserves remained robust ($600+ billion), ensuring currency stability.

Inflation and Monetary Policy

- Retail inflation averaged 5.4%, within the RBI's target range.
- Food price volatility, particularly in vegetables and pulses, posed temporary inflationary risks.
- The RBI maintained a cautious monetary stance, balancing growth with price stability.

Chart I.46: Food price pressures driving retail inflation

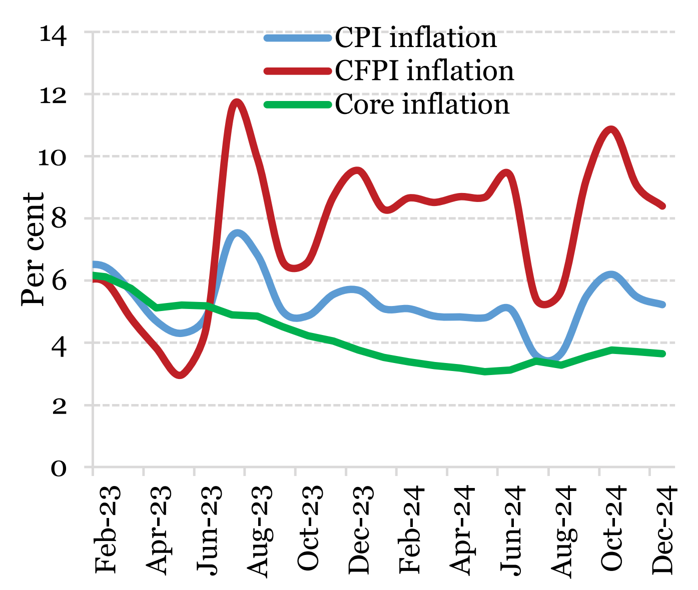
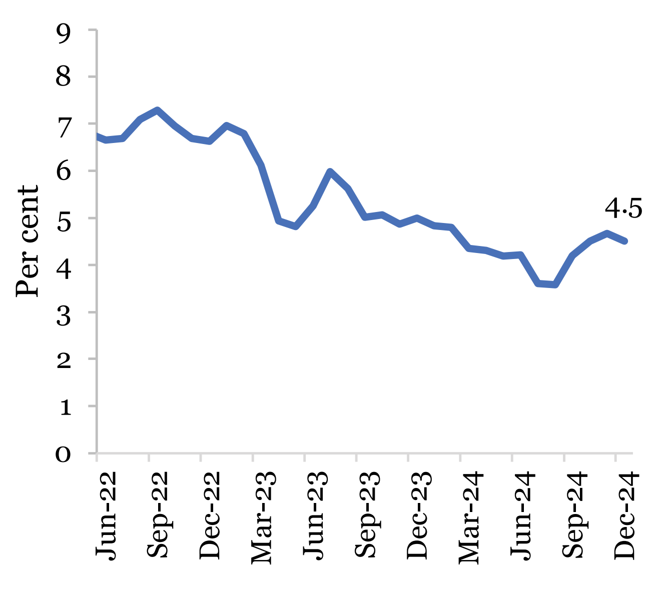


Chart I.47: CPI inflation excluding TOP commodities significantly lower[32]

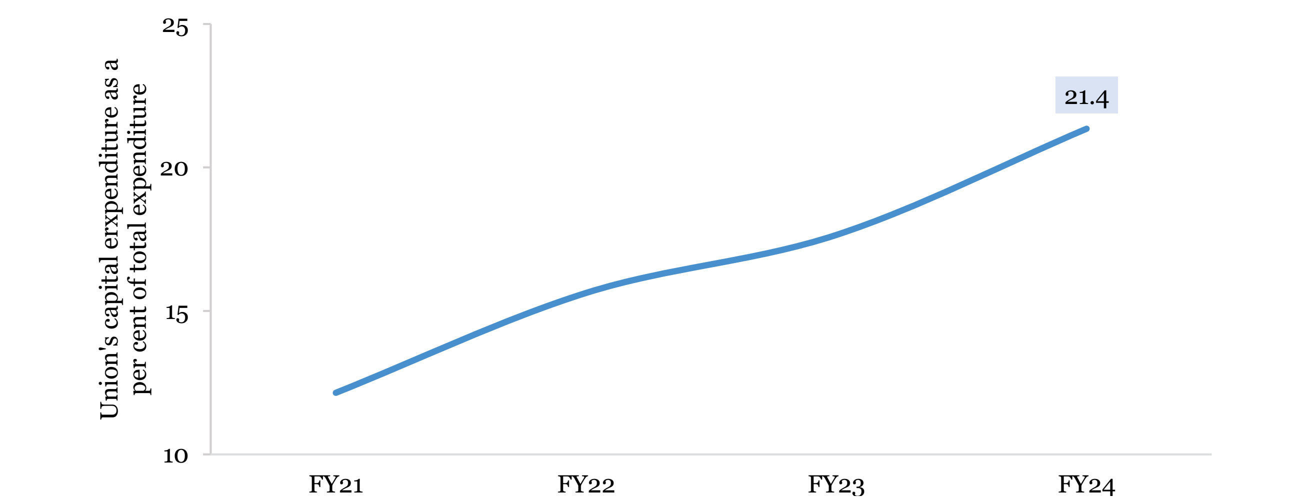


Source: Consumer Price Indices released by Central Statistical Office (CSO), MoSPI

ECONOMY CHARACTERISED BY STABILITY AND INCLUSIVITY ON MULTIPLE FRONTS

Public Finance and Fiscal Discipline

Chart I.35: Strong focus on fiscal discipline



Source: Union Budget documents. Provisional actuals for FY24.

- Private corporate savings hovering around 14 % of GDP
- Prudent fiscal management in the last four years kept the overall savings-investment gap from widening and ensured a comfortable financing of the current account deficit
- The Union government's indicators of fiscal discipline have improved progressively
- Capex remained subdued in the Q1 FY25 due to general elections
- However, Gross Tax Revenue increased by 10.7% YoY
- The deficit indicators of the union were comfortably placed, leaving ample room for developmental and capital expenditure in the rest of the year.

Varying patterns in state finances

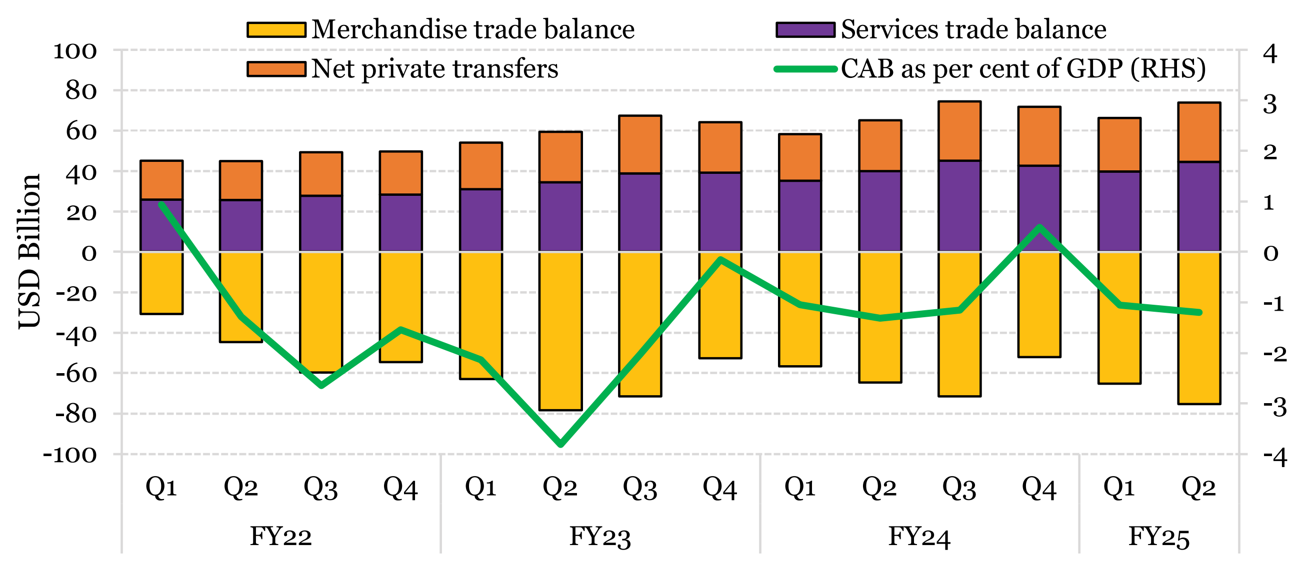
- Own tax revenue (OTR) of the states have increased at comparable pace during April-November 2024
- The overall tax revenue position of the state governments appears better because of increased tax devolution by the union.
- The revenue expenditure of the states grew at 12 per cent (YoY) during April to November 2024.

On Inflation Front

- A combination of low and stable core inflation with volatile food prices
- However, downward monthly volatility in food prices
- Pressures in food prices have been driven by factors such as supply chain disruptions and vagaries in weather conditions

External sector stability

Chart I.48: Services trade surplus and private transfers lending balance to the external sector



- A decline in commodity prices affected India's merchandise exports through the petroleum goods channel.
- Gold imports also grew, influenced by higher global prices, early purchases ahead of festive spending, and demand for safe-haven assets.
- India's merchandise trade deficit was supported by India's services trade surplus leading to the overall trade deficit.
- Remittances from abroad led to a healthy net inflow of private transfers, India being the top recipient of remittance in the world.
- Comfortable financing of the CAD by capital account has ensured external sector stability.
- Net FDI inflow declined, primarily on account of the uptick in repatriation of profits by global firms stationed in India

Forex Situation

- India's foreign exchange reserves increased from
- USD 616.7 billion at the end of January 2024 to USD 704.9 billion in September 2024 before moderating to USD 634.6 billion as on 3 January 2025.
- Sufficient to cover 90 % of external debt and provide an import cover of more than ten months

Financial sector prospects

- Bank credit growth was strong at 15.2%, driven by MSMEs, personal loans, and corporate lending.
- Non-Performing Assets (NPAs) declined to below 4%, reflecting a healthier banking system.
- The capital-to-risk-weighted assets ratio (CRAR) for SCBs stands at 16.7% as of September 2024, well above the norm

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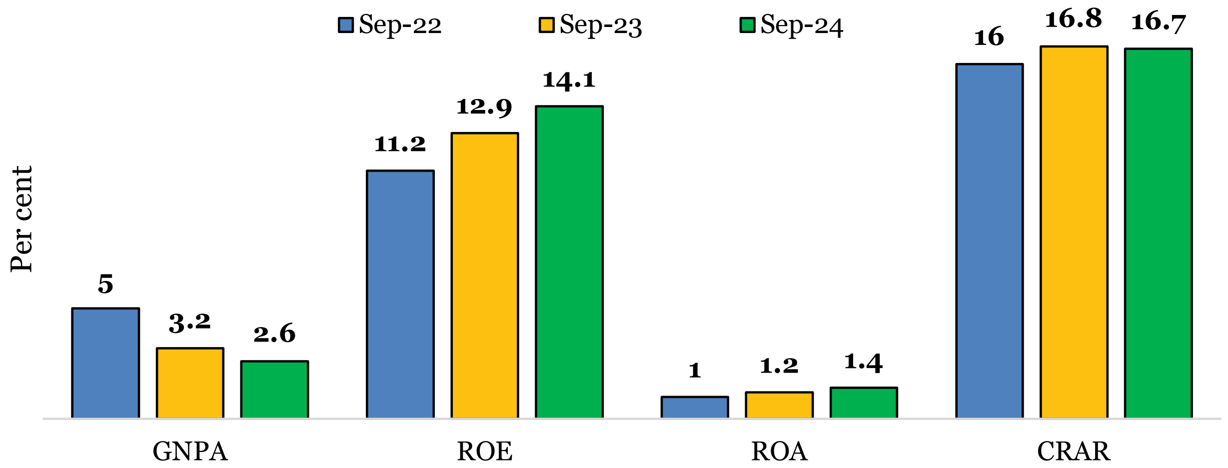
Chart I.51: Stable banking system indicators

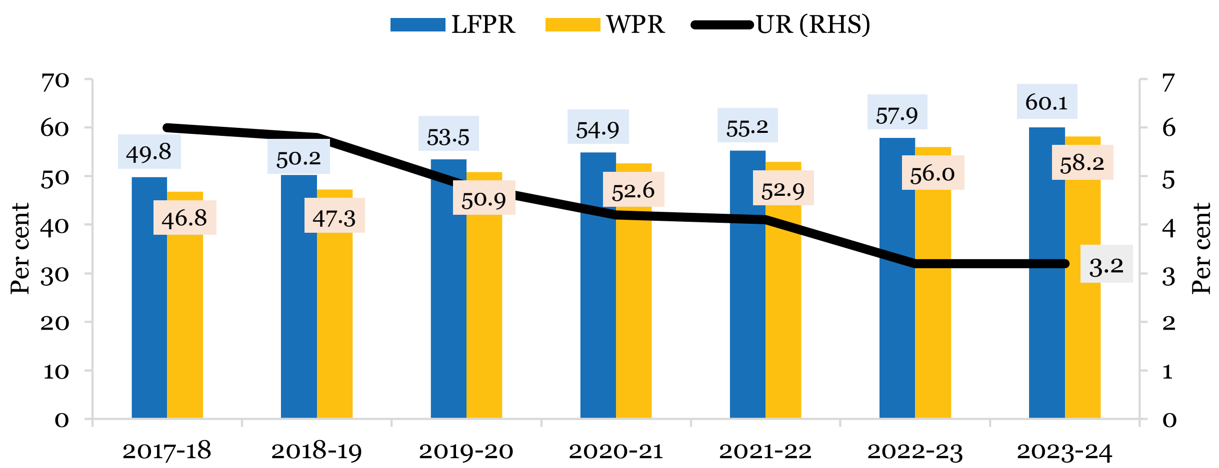


Source: Various editions of RBI Financial Stability Report

- Profit after tax (PAT) surging by 22.2% YoY, while the Return on Equity (RoE) and Return on Assets (RoA) have improved on a YoY basis.
- Concern- stress on unsecured credit, i.e., personal loans and credit cards.
- Stock markets performed well, making India the fifth-largest equity market globally.

Employment trends

Chart I.52: Improvement in employment indicators



Source: Annual PLFS report 2023-24, MoSPI
Note: i) **LFPR** - labour force participation rate, **WPR** - worker-to-population ratio, **UR**- unemployment rate
ii)Statistics presented are by Usual status for persons aged 15 years and above

- India's labour market supported by post-pandemic recovery and increased formalisation
- Net Employees' Provident Fund Organisation (EPFO) subscriptions more than doubled from 61 lakh in FY19 to 131 lakh in FY24.
- Wider discussion on the impact of Artificial Intelligence (AI) on India's labour market.

OUTLOOK AND WAY FORWARD

Outlook

- India is projected to sustain 7%+ growth in the coming years, supported by:
- Expanding manufacturing capacity under Make in India
- Continued role of service sector in driving global growth
- Easing inflation pressure globally
- Pickup in rural demand is expected

Risks and Challenges

- Global recessionary risks and potential financial market volatility.
- Risks of synchronised price pressures linger due to potential geopolitical disruptions
- Supply chain disruptions, energy security concerns, and climate change risks.
- Labour market shifts, requiring a focus on skill development and automation.

CONCLUSION

India's economy is navigating a steady recovery amid global uncertainties, driven by strong domestic demand, resilient financial markets, and government-led infrastructure investment. While external risks such as geopolitical tensions and supply chain disruptions persist, robust fiscal management and digital transformation support long-term growth. With reforms focusing on deregulation, financial inclusion, and job creation, India is well-positioned to sustain its high-growth trajectory. However, maintaining macroeconomic stability, boosting exports, and improving ease of doing business will be critical for achieving a $5 trillion economy in the coming years.

Practice Questions

1. Discuss the key macroeconomic challenges that India faces in sustaining high growth amid global uncertainties. Suggest policy measures to address these challenges. (10 Marks)
2. "India's economic growth is largely driven by domestic demand rather than exports." Critically analyse this statement. (10 Marks)

CHAPTER 2: MONETARY AND FINANCIAL SECTOR DEVELOPMENTS: THE CART AND THE HORSE

INTRODUCTION

The monetary and financial sectors have been strong performers in FY25, with stable credit growth, improving financial intermediation, and rising capital market activity. Monetary policy remained stable, focusing on liquidity management and inflation control while ensuring economic expansion. The banking sector strengthened further, with lower NPAs, higher capital adequacy, and strong profitability. Financial inclusion initiatives expanded, with the Financial Inclusion Index rising from 53.9 (March 2021) to 64.2 (March 2024). Stock markets achieved record highs, positioning India as a leading emerging market investment destination. However, challenges such as rising unsecured lending, credit expansion risks, and global financial uncertainties require prudential oversight.

MONETARY DEVELOPMENTS

Inflation and Interest Rate Trends

- Inflationary pressures moderated globally, allowing a shift in monetary policy approaches.
- India's CPI inflation averaged 5.4%, within the RBI's tolerance band.
- Core inflation eased due to stable commodity prices, but food inflation remained volatile, particularly for vegetables, pulses, and cereals.
- The Monetary Policy Committee (MPC) of the RBI, in its various meetings, decided to keep the policy repo rate unchanged at 6.5%
- October 2024 MPC Meeting: Stance changed from 'withdrawal of accommodation' to 'neutral'
- December 2024 MPC Meeting: MPC announced a cut in CRR to 4% from 4.5%

Global interest rate trends impacted India's monetary stance:

- The US Federal Reserve and ECB paused rate hikes, signaling potential easing.
- India maintained a cautious approach, balancing growth support with inflation control.

Liquidity Management and Money Market Trends

- Interbank liquidity conditions remained stable, supported by:
  - Moderate government borrowing
  - Efficient forex market operations
  - Improved credit-deposit ratios in the banking sector
  - Money market rates aligned closely with the repo rate, reflecting effective liquidity control.

FINANCIAL INTERMEDIATION

Banking Sector Performance

- Bank credit growth remained strong at 15.2%, driven by:
- Corporate lending in infrastructure, renewable energy, and manufacturing
- MSME sector credit expansion, aided by targeted government schemes
- Personal loans and housing finance growth

Banking sector resilience improved significantly, as reflected in:

  - Gross NPAs declined consistently from its peak in FY18 to a 12- year low of 2.6% at the end of September 2024
  - Lower GNPAs and higher provisions accumulated in recent years also contributed to a decline in net NPAs at around 0.6%
  - Capital-to-risk-weighted assets ratio (CRAR) at 16.7% (well above regulatory norms)

Chart II.3a: Decline in GNPAs of SCBs

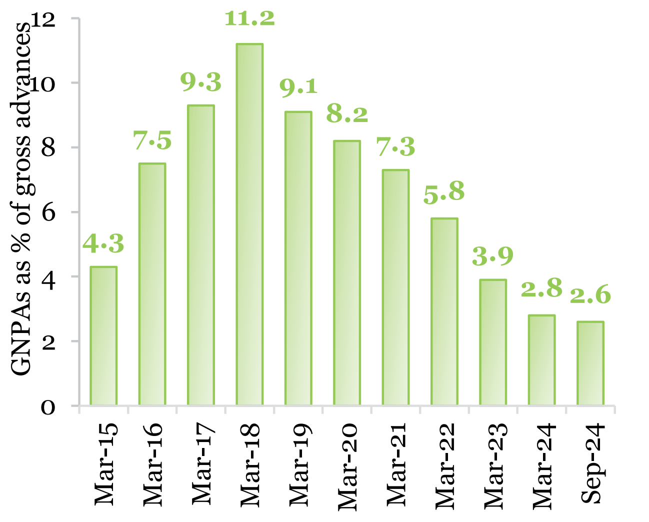
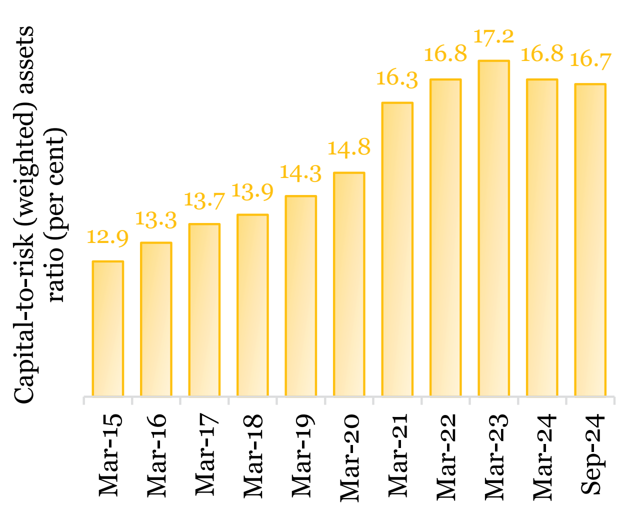


Chart II.3b: CRAR well above the required norms

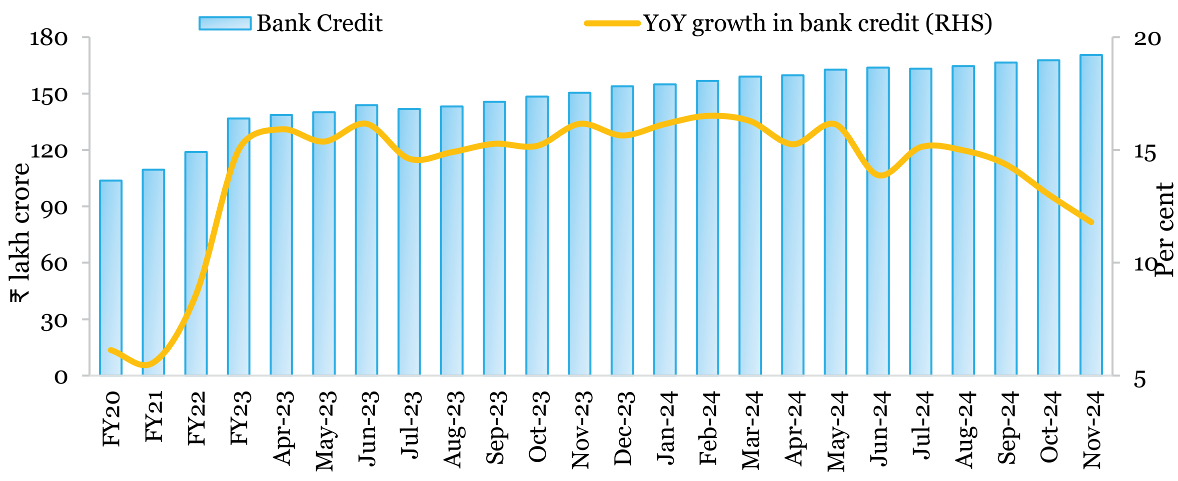


Source: RBI Financial Stability report, various issues

- Profit after tax (PAT) growth of 22.2% YoY for Scheduled Commercial Banks
- Higher return on assets (RoA) and return on equity (RoE), but Net Interest Margin (NIM) has marginally declined across all bank groups.

Trends in Bank Credit

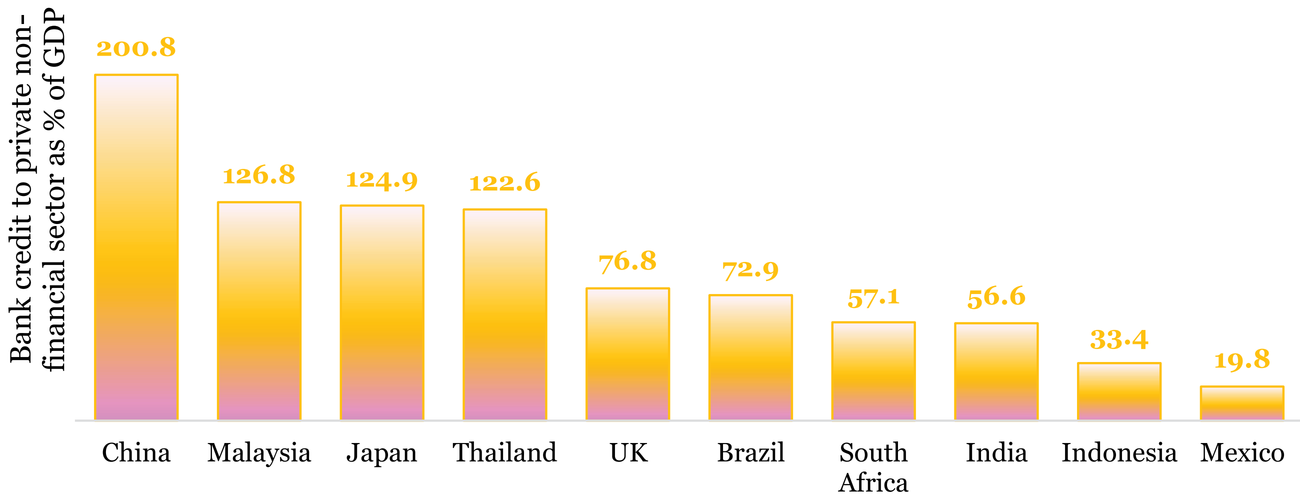
Chart II.5: Trend in credit disbursal by SCBs



Source: RBI data on sectoral deployment of bank credit

- Bank deposits continue to exhibit double-digit growth.
- Growth in term deposits continues to outpace the current and savings account deposit growth.
- The growth rate in non-food credit has moderated to 7.5% compared to a growth of 11% over the same period last year.
- Bank credit to private non-financial sector to GDP ratio is lower than Advanced Economies (AEs)

Chart II.7: Cross-country comparison of bank credit to private non-financial sector as per cent of GDP[11]



Source: Bank for International Settlements

Non-Banking Financial Companies (NBFCs) and Digital Lending

- NBFCs continued to expand, with rising credit disbursements in retail and MSME segments.
- Digital lending gained traction, with fintech-driven instant loan approvals and alternative credit models.
- However, concerns over unsecured lending growth emerged, particularly in personal loans and credit card segments.
- Regulatory oversight increased to mitigate systemic risks from excessive consumer credit expansion.

Rural Financial Institutions and Development Finance

Rural Financial Institutions (RFIs) played a key role in financial inclusion, supporting:

- Agricultural credit expansion
- Microfinance and self-help group (SHG) lending
- Rural MSME financing

(RBI's Financial Inclusion Index rose from 53.9 in March 2021 to 64.2 by March 2024.)

Regional Rural Banks (RRBs) landscape

- Established in 1975 under the Regional Rural Banks Act of 1976.
- There were 133 RRBs in 2006, which has been brought down to 43 in 2023
- 31.3 crore deposit accounts and 3 crore loan accounts in 26 states and 3 UTs.
- The consolidated net profit of RRBs increased from about Rs 5000 crore in FY23 to more than Rs 7500 crore in FY24
- Asset quality of RRBs measured by GNPA as a percentage of gross advances improved from 7.3%in FY23 to 6.1% in FY24, lowest in past ten years

Development Financial Institutions

- Development Financial Institutions (DFIs) contributed to infrastructure financing, ensuring:
- Long-term funding for key projects
- Stability in public-private investment models
- Five main DFIs: NABARD; SIDBI; NHB; EXIM Bank and NaBFID

Efficacy of Insolvency Law

- Ushered in a modern and comprehensive insolvency resolution framework for distressed entities
- 1068 resolution plans approved under the Code have resulted in creditors realising ₹3.6 lakh crore
- The deterrent effect of the Code has led to a significant shift in debtor behavior
- Focus on resolving distress in the early stages of distress, ie before its admission to avoid the consequences of resolution process
- Increase in the probability of currency hedging by firms
- Exporting firms in India have benefitted from the bankruptcy reform law by helping them better access credit and get out of financial constraints

Development in capital markets

- The number of investors growing from 4.9 crore in FY20 to 13.2 crore as of 31 December 2024
- The number of demat accounts rising sharply by 33 per cent to 18.5 crore at the end of December 2024
- The primary markets continued to witness heightened listing activities and investor enthusiasm in FY25
- India's share in global IPO listings surged to 30% in 2024, up from 17% in 2023
- However, there have been heightened volatility in secondary equity market (stock market)
- Reasons: Stimulus measures in China, the US Presidential elections and valuation concerns

Table II.1: Market capitalisation to nominal GDP ratio (percentage)

	India	China	Brazil	Japan	South Korea	United Kingdom	United States
Dec-19	77	60	65	121	89	106	158
Dec-20	95	79	68	129	122	92	195
Dec-21	113	80	50	136	127	108	206
Dec-22	105	65	42	126	96	91	157
Dec-23	124	61	44	147	114	71	179
Dec-24*	136	65	37	157	90	84	213

- BSE market capitalisation to GDP ratio stood at 136% at the end of December 2024, which is one of the highest in the world
- Remarkable increase in mutual funds' assets under management (AuM), which rose to ₹66.9 lakh crore as of December 2024 (2014: Rs 10 lakh crore)

Developments in the insurance sector

- Total insurance premium grew by 7.7% in FY24, reaching ₹11.2 lakh crore
- Insurance density saw a modest rise from USD 92 in FY23 to USD95 in FY24.
- Insurance penetration rate of 3.7%, below the global average of 7%
- The Swiss Re Institute has projected India's insurance sector to grow at a rate of 11.1%
- An expanding middle class, technological advancements, and supportive regulatory measures will likely drive this growth

Developments in the pension sector

- The World Economic Forum (WEF): For the first time globally, the number of people aged 65 and over has surpassed the number of children aged five and younger
- Retirees face increasing risks due to rising inflation and higher interest rates, which elevate the cost of government debt
- Public pension spending will increase by an average of 1% of GDP in AEs and 2.5% in EMEs by 2050.

India's pension sector

- Significant growth since the introduction of the National Pension System (NPS) and Atal Pension Yojana (APY)
- The government approved the Unified Pension Scheme (UPS) for Government employees that will be implemented along with the present NPS
- Extension of NPS to children through the NPS Vatsalya
- Pension assets account for 21.5% of the GDP (OECD countries: More than 80% of their GDP)
- Still only 5.3% of the total population is covered under either NPS or APY

RISKS PERTAINING TO INDIA'S FINANCIAL SECTOR

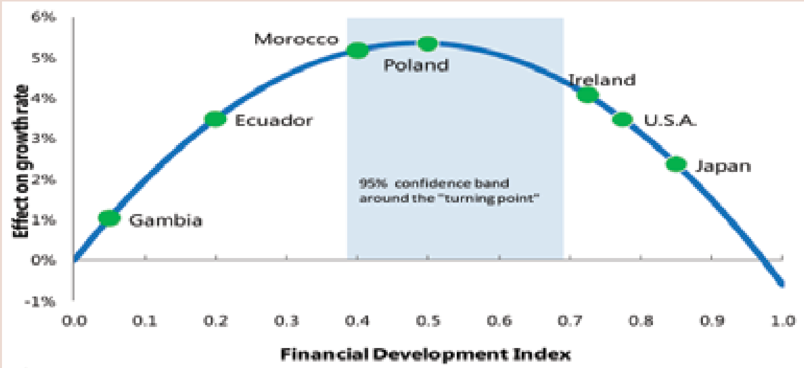
Rising Unsecured Lending and Credit Growth Risks

- Personal loan and credit card debt surged, raising concerns over consumer leverage risks.
- Stress in unsecured credit segments necessitated tighter prudential norms.
- The RBI introduced risk-mitigation measures, including:
  - Higher risk weights on personal loans
  - Stricter NBFC capital adequacy norms

Excessive financialisation in the economy

- Competition between financial sector and real sector for resources
- Shift of skilled labour towards the financial sector
- Development of products which do not add value to the real economy

Chart II.13: Financial development and growth – a bell-shaped relationship



Source – Rethinking financial deepening, IMF Staff Discussion Note, 2015

- Higher risks due to financial engineering creating complex products (Eg- Credit Default Swaps in Global Financial Crisis 2008)

Global Financial Uncertainty and Capital Flows

- Geopolitical tensions and monetary policy shifts influenced global capital flows.
- India experienced fluctuations in FPI (Foreign Portfolio Investment) inflows, with:
- Strong equity inflows into technology and infrastructure stocks
- Moderate debt market inflows due to US rate uncertainty

Foreign Direct Investment (FDI) inflows declined, primarily due to:

- Higher global interest rates affecting risk capital deployment
- Increased repatriation of profits by foreign firms in India

Digital Finance and Cybersecurity Risks

Rapid digital adoption in financial services increased cybersecurity challenges.

The RBI and SEBI enhanced cybersecurity protocols, ensuring:

- Stronger fraud detection mechanisms
- Tighter regulatory compliance for fintech platforms

OUTLOOK

The Indian financial sector is expected to grow, driven by:

- Robust credit demand from infrastructure, housing, and MSMEs
- Continued financial inclusion and digital finance expansion
- Strengthening of the banking sector through regulatory reforms

Policy recommendation

- Maintaining a fine balance between financial sector development and addressing the concern of excessive financialisation
- Try not to overlook regulatory challenges and potential risks

CONCLUSION

India's monetary policy framework remains resilient, ensuring price stability while supporting economic growth. Inflation remains under control, aided by effective liquidity management and global commodity price stability. The financial sector has strengthened, with lower NPAs, improved credit growth, and strong capital buffers in banks. However, challenges like external shocks, global interest rate volatility, and financial inclusion gaps persist. To sustain growth, policymakers must balance monetary tightening with economic expansion, ensuring credit availability for MSMEs and startups while leveraging fintech innovations for deeper financial penetration.

Practice Questions

1. The Economic Survey 2024-25 highlights the importance of balancing monetary tightening with economic expansion. Examine the role of the RBI in achieving this balance. (15 Marks)
2. Despite financial sector reforms, credit access for MSMEs and startups remains a challenge in India. Evaluate the effectiveness of recent policy measures to enhance financial inclusion. (10 Marks)

CHAPTER 3: EXTERNAL SECTOR – GETTING FDI RIGHT

INTRODUCTION

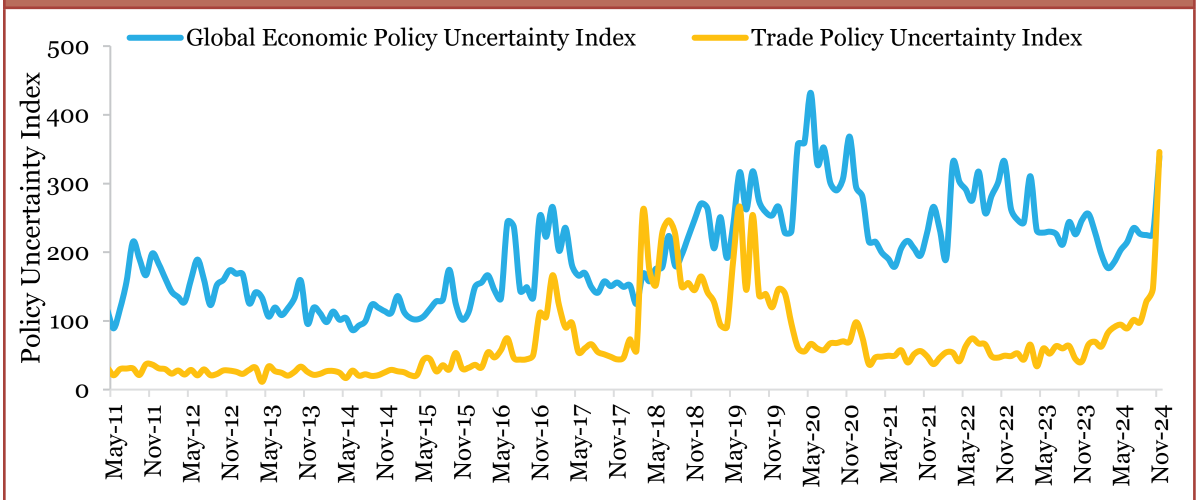
India's external sector has been a key driver of economic resilience, navigating global trade uncertainties and capital flow volatilities. Amidst a complex geopolitical environment and evolving trade policies, India's external engagement strategy focuses on enhancing FDI flows, diversifying export markets, and ensuring external sector stability. This chapter examines global trade dynamics, trends in India's trade performance, key reforms, and the balance of payments situation

GLOBAL TRADE DYNAMICS

Evolving Trade Landscape

- Global trade in 2024 remained volatile, influenced by:

Chart III.1: Rise in global uncertainty



Source: GEPU Index and TPU Index website

Disruption in Red Sea that forced changes in trade routes, causing higher shipping costs and longer delivery times

- Supply chain disruptions due to geopolitical conflicts in the Middle East
- The rise in Non-Tariff Measures (NTMs), which began after the COVID-19 pandemic and further fuelled by the conflict between Russia and Ukraine.
- Tightening monetary policies in advanced economies.
- Trade restrictions and protectionist measures (e.g., CBAM by the EU).

Chart III.3: Rebound in global trade in 2024

Source: WTO Stats

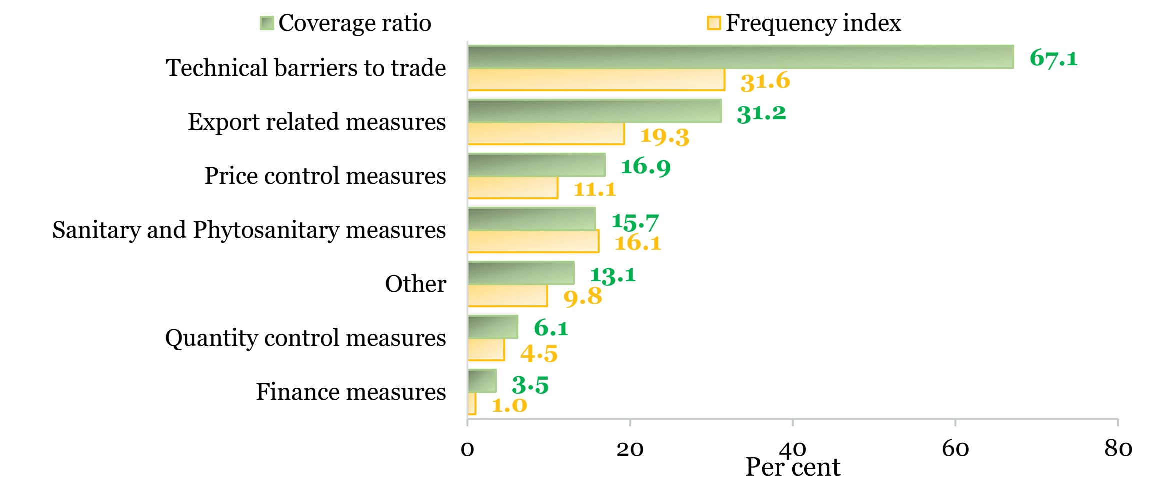
Tariffs and successful industrial policy design

- Tariffs are a standard tool of industrial policy and are often seen as a way to support fledgling industries before they gain traction
- Modern-day industrial policies use a mix of policies, including tariff-based protection and other levers such as credit grants and export-related subsidies
- The recipe for a successful industrial policy lies in the simultaneous use of carrots and sticks, with the sticks often being longer than the carrots.
- East Asian and South-East Asian economies succeeded with its industrial policy because it punished non-performers more than it rewarded performers.

Non-tariff measures

- Between 2020 and 2024, over 26,000 new restrictions related to trade and investments have been globally imposed.
- Technical Barriers to Trade (TBT) affect 31.6% of the product lines, covering 67.1% of the global trade (as of December 2024).

Chart III.4: Classification of NTMs based on coverage and frequency



- Unlike broad-based tariffs, NTMs tend to be granular and are often less visible, making them harder to assess.
- NTMs are playing an increasing role in international trade due to a decline in the usage of tariffs worldwide via successive agreements under the General Agreement on Tariffs and Trade/WTO
- Though many NTMs aim primarily to protect public health or the environment, they also adversely impact trade by increasing information, compliance, and procedural costs.

CBAM and EUDR

1. Carbon Border Adjustment Mechanism (CBAM)

Table III.1: India's exposure to CBAM Value of exports (USD million)

	2014	2023
Iron and steel	2962.6	5557.1
Aluminium	151.4	1801
Cement	4.2	8.3
Fertilisers	0.7	2

Source: UNCOMTRADE database (2024)

- CBAM aims to align the cost of carbon emissions for imported goods with that of domestically produced products.
- As countries/groups like the EU phase out the free allowances they offer their industries under the Emissions Trading System (ETS), they are ushering in CBAM to prevent their consumption from shifting to countries with relatively softer environmental regulations.
- CBAM aims to equalise carbon prices across geographies, thereby negating the comparative advantage of developing members like India and the least developed countries.

2. European Union Deforestation Regulation (EUDR)

- It seeks to regulate the consumption of products derived from deforested land.
- It requires the operators and traders to ensure that the products placed in the EU market are (i) deforestation-free (ii) should be produced by the relevant legislation of the country where the product is produced; and (iii) covers the submission of a due diligence statement, including supply chain integrity through an elaborate trace and track system before placing the products in the EU

The CBAM and EUDR are expected to affect USD 9.5 billion of India's exports to the EU, which amounts to 9 per cent of India's exports to the world or 12.9 per cent of India's exports to the EU.

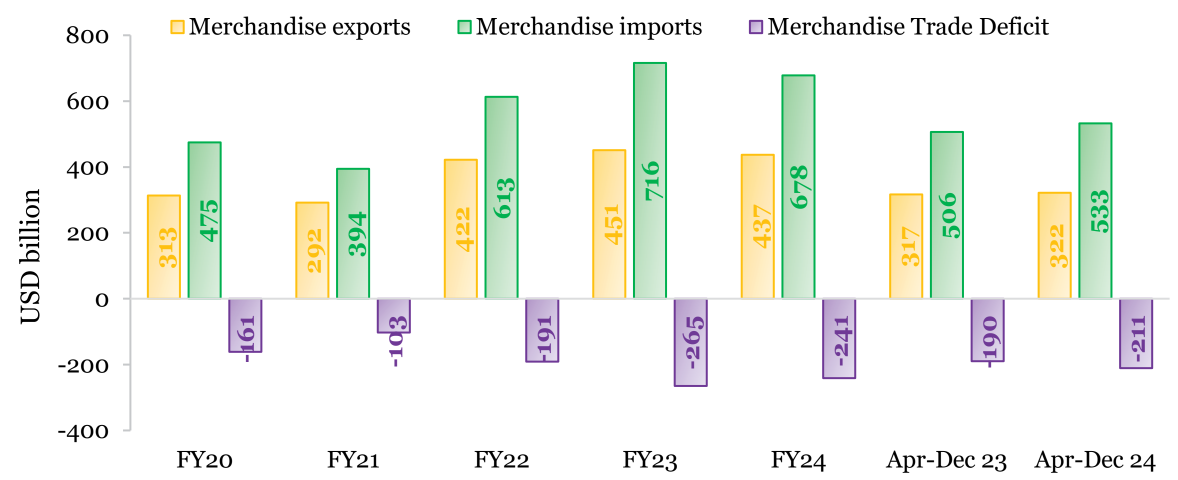
TREND IN INDIA'S TRADE PERFORMANCE

Merchandise Trade Trends

Exports

- In the first nine months of FY25, reaching a value of USD 602.6 billion

Chart III.5: Trends in merchandise trade



Source: DGCIS, M/o Commerce & Industry

- Despite global headwinds, India's exports showed resilience, led by:
- Engineering goods (Auto components, industrial machinery).
- Electronics (PLI-driven surge in mobile phone exports).
- Pharmaceuticals (Strengthened global supply chains).

Imports

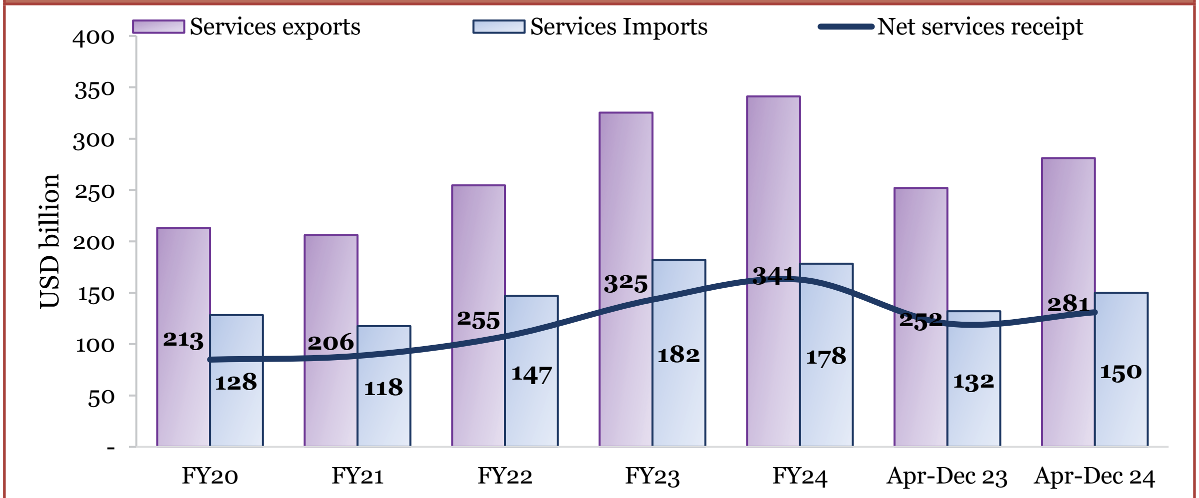
- Total imports during April-December 2024 reached USD 682.2 billion
- Moderation in commodity prices reduced the import bill, while demand for capital goods remained robust.
- Gold imports increased due to higher international prices, driven by frontloading ahead of festival spending and demand for safe-haven assets.

Trade Deficit & Adjustments

- Merchandise trade deficit widened due to increased import costs, but strong services surplus offset the impact.
- Top Trading Partners: US, EU, China, and UAE accounted for over 50% of India's trade.

Services Sector Driving Surplus

Chart III.10: Rise in net services receipts in the first nine months of FY25



Source: RBI

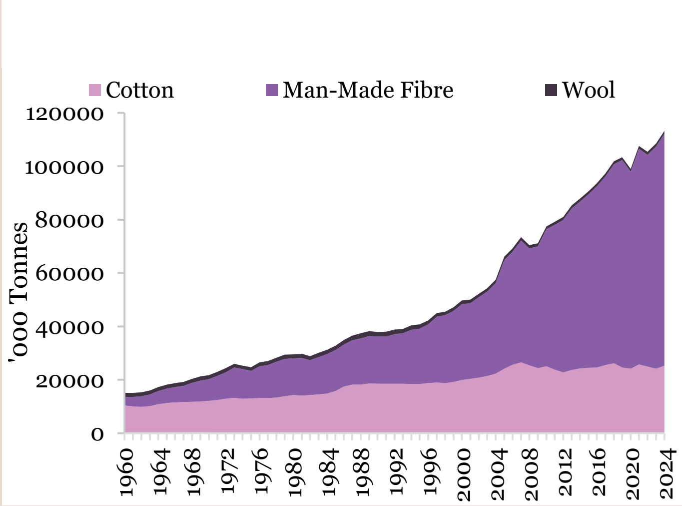
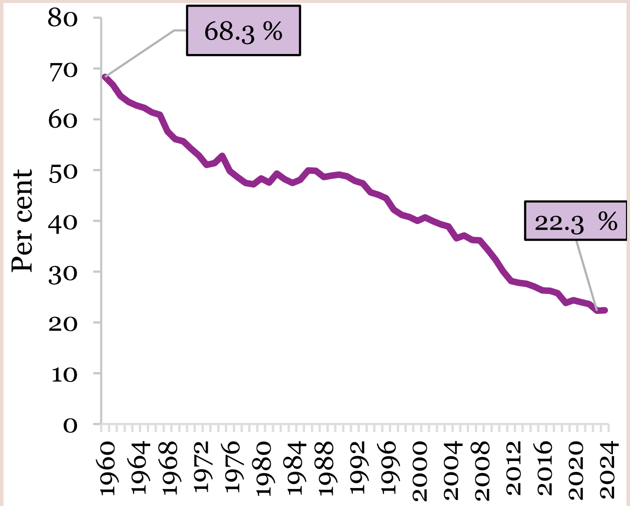
- India's share in global services exports has more than doubled, reaching around 4.3% in 2023 from 1.9% in 2005.
- India's IT, financial, and professional services continued to drive current account stability.
- Global Capability Centres (GCCs) expansion reinforced India's role as a global services hub.
- Remittances remained strong, contributing to a favorable balance of payments position.

India's e-commerce exports

- According to a report, the global B2C e-commerce market is expected to grow from USD 5.7 trillion in 2022 to USD 8.1 trillion by 2026 at a CAGR of 9.1 per cent.
- India's B2C e-commerce market was worth USD 83 billion in 2022, and it is anticipated to grow to USD 150 billion by 2026, showing a CAGR of 15.9%
- India's e-commerce market makes up a small fraction, about 1.5% of the global market, and it is projected to stay around 2% in the coming years.
- Government Schemes promoting e-commerce exports: Niryat Bandhu scheme; Market Access Initiative (MAI) scheme; Export and packing credit; E-commerce export hubs

Rise of Man-Made Fibre

- While our comparative advantage lies in cotton and cotton-based products, global demand has shifted to products made from man-made fibre (MMF).

Chart III.7: World consumption of major textile fibres	Chart III.8: Cotton's market share in the global market for fibres
	

Source: International Cotton Association (ICA)

- MMF comprised 77% of global fibre consumption in 2024, whereas it was just 22% for cotton.
- India's share of global MMF production is currently 9.2%
- National Technical Textiles Mission (NTTM) has been approved with an outlay of ₹1,480 crore
- Pradhan Mantri Mega Integrated Textile Region and Apparel (PM-MITRA) parks across to create world-class infrastructure and invite FDI into the textile sector.

EASE OF DOING BUSINESS INITIATIVES FOR EXPORTERS

Trade Facilitation & Digitalization

- Simplified compliance under GST and e-customs reduced transaction costs for exporters.
- Trade Infrastructure for Export Scheme (TIES) modernized ports and logistics hubs.
- Unified Logistics Interface Platform (ULIP) improved multimodal transport efficiency.

Free Trade Agreements (FTAs) & Market Access

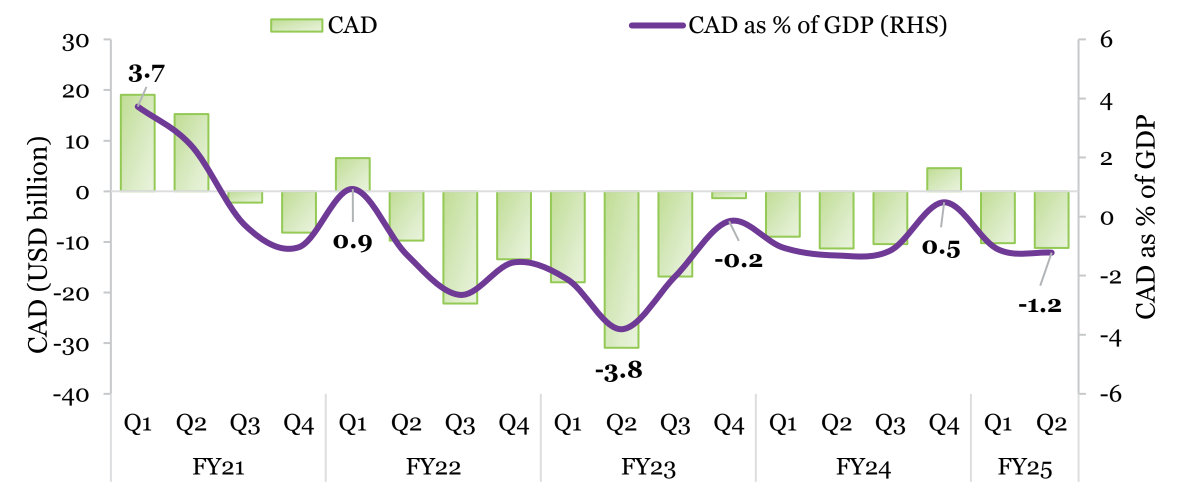
- India expanded FTAs with UAE, Australia, and ongoing talks with the EU, UK, and GCC.
- India-Middle East-Europe Economic Corridor (IMEC) set to boost trade integration.

BALANCE OF PAYMENTS: RESILIENCE AMID CHALLENGES

Current Account Trends

- Current Account Deficit (CAD) remained moderate at 1.2% of GDP in Q2 of FY25 against 1.3% of the GDP recorded in Q2 of FY24.
- Private transfers in India, mainly remittance was robust despite economic uncertainties

Chart III. 11: Trend in current account deficit



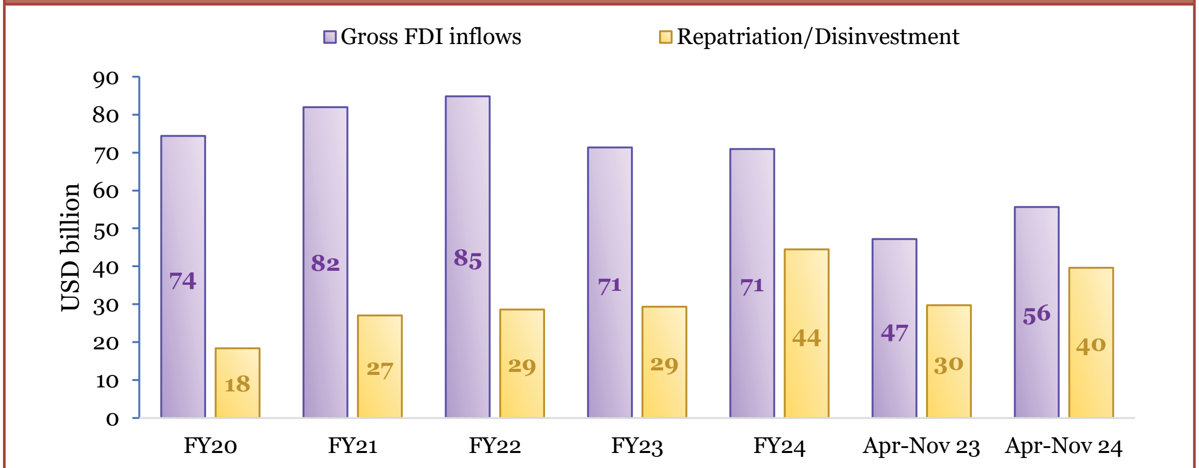
Source: RBI press release on developments in India's Balance of Payments during the second quarter (July-September) of 2024-25

- Net service receipts bolstered forex reserves.

Foreign Direct Investment (FDI) – Strengthening India's Position

- Gross FDI inflows increasing from USD 47.2 billion in the first eight months of FY24 to USD 55.6 billion in the same period of FY25
- Over the long term, FDI inflows into India have surpassed the USD 1 trillion mark from April 2000 to September 2024, solidifying the country's position as a safe and significant global investment destination.
- India remains one of the top FDI destinations, with inflows driven by:
- Manufacturing sector investments in EVs, electronics, and semiconductors.

Chart III.14: Trends in gross FDI inflows

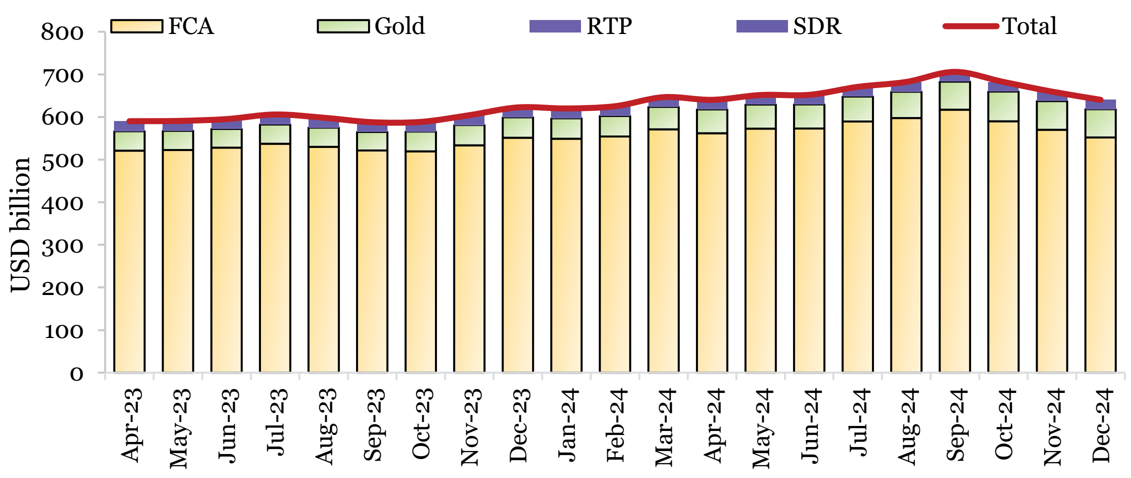


Source: RBI

- Digital economy & fintech growth.
- PLI-induced FDI in high-tech industries.
- Concern: Rise in repatriation due to possible weakness in economy in the near term

- The net FDI inflows during the first eight months of FY25 stood at USD 0.48 billion compared to USD 8.5 billion in the corresponding period of FY24
- Reasons: Higher US Fed yield becoming favourable; Lower return in dollar terms due to depreciated INR

Chart III.19: Movements in foreign exchange reserves



Source: RBI

Foreign Exchange Reserves

- After surpassing the USD 700 billion benchmark, India's foreign exchange reserves moderated to USD 640.3 billion as of the end of December 2024.
- The import cover, a crucial indicator of external sector stability, stood at 10.9 months as of December 2024.
- India ranks 4th globally, following China, Japan, and Switzerland.

Exchange Rate

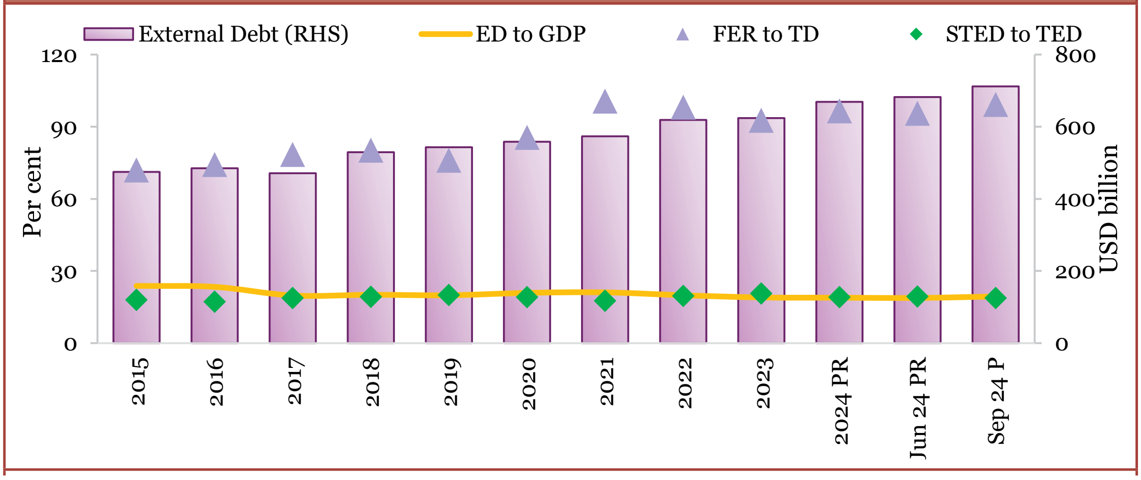
Chart III.20: Changes in the bilateral exchange rates of the major countries against USD from April to December 2024

- The INR depreciated a modest 2.9%, performing better than currencies such as the Canadian Dollar, South Korean Won and the Brazilian Real
- The Nominal Effective Exchange Rate (NEER) for the INR remained stable in the 90-92 range

- Real Effective Exchange Rate (REER), which reflects the real purchasing power of the currency, steadily increased from 103.2 in April 2024 to 107.2 in December 2024.

External debt position

Chart III.22: India's stable external debt position



- The external debt to GDP ratio rose slightly from 18.8% of the GDP at the end of June 2024 to 19.4% at the end of September 2024.
- The share of short-term debt (with original maturity of up to one year) in total external debt decreased to 18.8% at the end of September 2024 from 19.4% at the end of June 2024.
- Short-term debt to foreign exchange reserves ratio decreased to 18.9% at the end of September 2024 from 20.3% at the end of June 2024.

OUTLOOK

Global Uncertainties

- US monetary tightening and geopolitical shifts may impact FDI flows.
- Protectionist policies (CBAM, digital trade barriers), accompanied by increased uncertainty, pose challenges.

Growth Drivers

- Expansion of PLIs to new sectors (battery storage, semiconductors).
- Improving trade logistics & infrastructure.
- Strengthening bilateral trade with new FTA partners.

Policy Recommendations

- Enhance trade competitiveness through targeted reforms in logistics & regulations.
- Strengthening FDI frameworks to attract high-value investments.
- Expand service sector exports via fintech & digital infrastructure growth.
- Sustainable trade practices to align with global environmental norms.

CONCLUSION

India's external sector remains resilient, supported by robust FDI inflows, export diversification, and stable foreign exchange reserves. Despite global trade disruptions, protectionist measures, and geopolitical risks, India continues to strengthen bilateral and multilateral trade partnerships. Foreign direct investment (FDI) policies are evolving, focusing on easing regulatory barriers and attracting high-tech investments. However, reducing trade deficits, boosting export competitiveness, and strengthening manufacturing capabilities remain key challenges. Going forward, policy support for high-value exports, supply chain diversification, and enhanced ease of doing business will be essential to maintaining external sector stability.

Practice Questions

1. Foreign Direct Investment (FDI) is crucial for India's external sector resilience. Analyse the key challenges in attracting high-value FDI and suggest policy interventions. (15 Marks)
2. How can India enhance its export competitiveness amid global trade disruptions and protectionist measures? Discuss. (10 Marks)

CHAPTER 4: PRICES AND INFLATION – UNDERSTANDING THE DYNAMICS

INTRODUCTION

Inflation is a critical economic indicator that affects both policymakers and consumers. While global inflation peaked in 2022 due to supply chain disruptions and geopolitical tensions, it has moderated in 2024 due to policy interventions and easing commodity prices. However, India's food inflation remained volatile, primarily driven by supply shocks in vegetables, pulses, and cereals.

GLOBAL INFLATION

- Global Resilience Amid Synchronized Monetary Tightening

Chart IV.1a: Headline inflation eases across countries

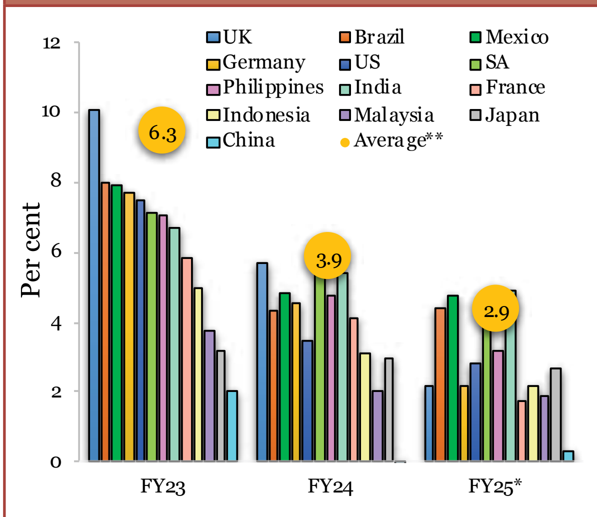
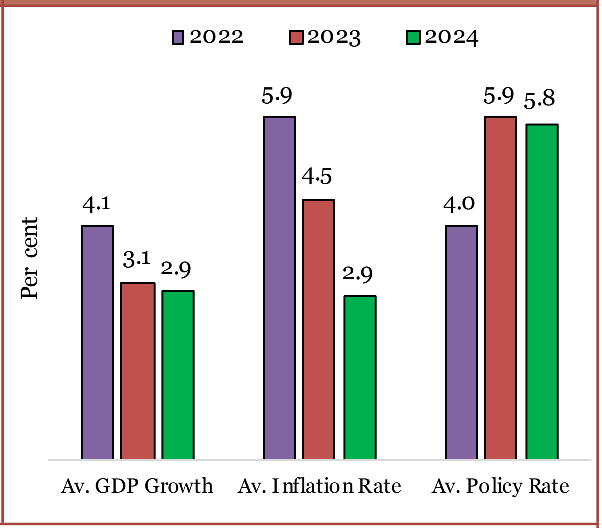


Chart IV.1b: Monetary targeting lowered inflation and stabilised output globally

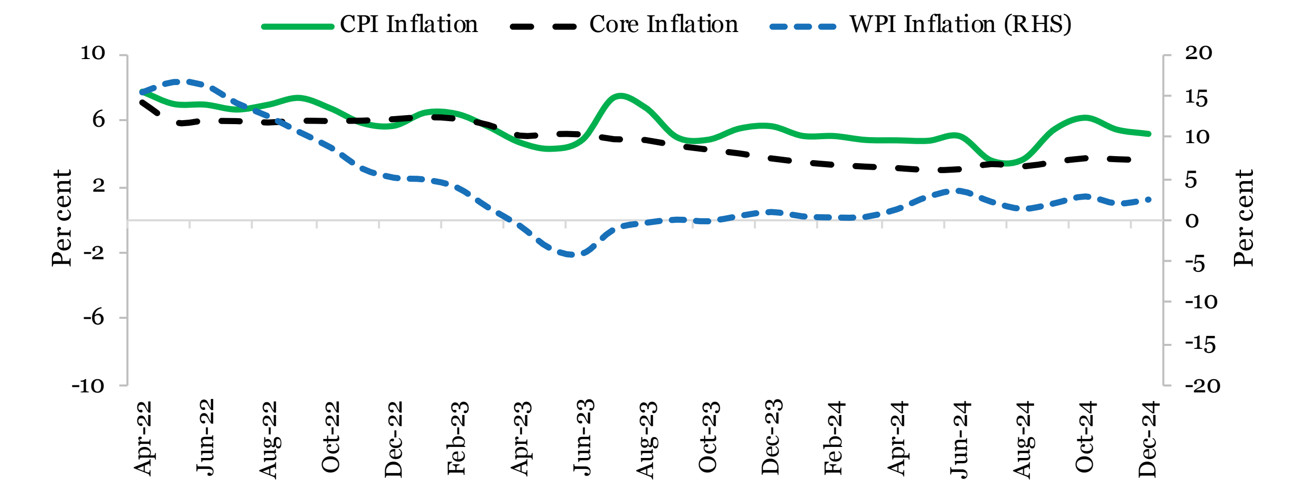


- Global headline inflation declined from 8.7% in 2022 to 5.7% in 2024 due to:
- Tightening monetary policies by central banks by increasing interest rates
- Lower energy prices and easing supply chain disruptions
- Higher food production due to solid harvests and favourable growing conditions in advanced economies
- Decline in core inflation predominantly attributed to a moderation in international commodity prices
- However, inflation remained high in some emerging markets like Brazil, India, and China due to localised supply shocks.

DOMESTIC INFLATION

- India's headline inflation (CPI) moderated from 5.4% in FY24 to 4.9% in FY25 (April-Dec).

Chart IV.4: Headline and core inflation under control



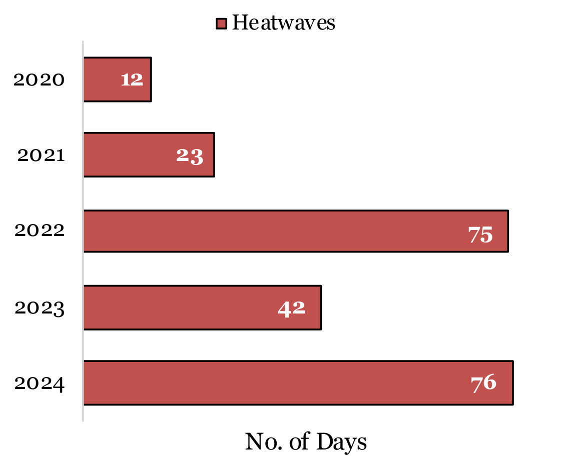
Source: Consumer Price Indices released by CSO, MoSPI

- Core inflation (excluding food and fuel) fell by 0.9 percentage points, reaching a decade low.
- Wholesale Price Index (WPI) inflation remained in the negative zone at -0.7% in FY24, reflecting lower input costs.

Food Inflation – A Key Challenge

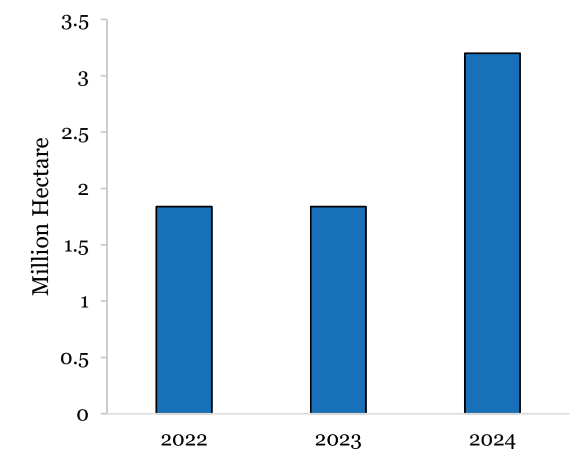
- Food inflation remained high at 8.4% in FY25 (April-Dec), driven by:
- Vegetables and pulses, which contributed 32.3% to overall inflation despite having just 8.42% weight in the CPI basket.
- Supply shocks in onion due to erratic monsoons, leading to lower production in crucial Rabi season
- Post-harvest losses which were evident in softer vegetables like tomato as well as seasonal production, and regional dispersion in production. The highly perishable nature of tomatoes restricts import options from neighbouring countries
- Extreme weather events such as cyclones, heavy rains, floods, thunderstorms, hailstorms, and droughts impacting vegetable prices On an average, during 2022-2024, India experienced heatwaves on 18% of days compared to 5% of days in 2020 and 2021.

Chart IV.8: Heatwaves increased in last three years



Source: IMD, Ministry of Earth Sciences

Chart IV.9: Rise in crop area damaged due to weather conditions



Source: India's database of weather disasters dashboard by CSE DTE Data[4].

- Higher international prices of edible oils impacting domestic markets, particularly for palm oil
- Lower production of pulses, particularly tur dal, also contributed to food inflation in India.

Box IV.1: Administrative measures to control food inflation

Food items	Measures undertaken
Cereals	• Stock limits on wheat from 24 June 2024 to 31 March 2025. • Open Market Sale Scheme: Offloaded wheat and rice from the central pool • Sale of wheat flour and rice under Bharat brand
Pulses	• Sale of chana dal, moong dal and masur dal under Bharat brand • Stock limits on tur and desi chana from 21 June 2024 to 30 September 2024 • Allowed duty-free import of desi chana, tur, urad and masur until 31 March 2025. • Allowed duty free import of yellow peas until 20 February 2025.
Vegetables	• Buffer Stock of Onion: A total of 4.7 lakh MT of rabi onion has been procured under Price Stabilisation Fund. • 20 per cent export duty on onion since 13 September 2024. • Subsidised sale of onion at ₹35 per kg from September -December 2024. • Subsidised sale of Tomato at ₹65 per kg in October 2024

Source: Various PIB releases

OUTLOOK AND WAY FORWARD

- A normal southwest monsoon in 2024 has improved the water levels in reservoirs, ensuring sufficient water for irrigation during the rabi crop production.

- Rising international vegetable oil prices may pose an upside risk to food inflation.

The government has focused on controlling food inflation through various supply side measures like:

- Strengthening the buffer stock of essential food items
- Periodic open market releases
- Subsidised retail sale of essential food items in specified outlets
- Easing imports of the essential food items through rationalisation of duties
- Prevention of hoarding through imposition/ revision
- Monitoring of stock limits.

Ensuring long-term price stability - Measures recommended

- Focused research is needed to develop climate-resilient crop varieties, enhancing yield and reducing crop damage
- Concrete efforts needed to expand the area under pulses in rice-fallow regions
- Farmers should receive training on best practices, the use of high-yield and disease-resistant seed varieties
- Targeted interventions to improve agricultural practices in the major growing regions for pulses, tomatoes, and onions
- Implementing robust data collection and analysis systems to monitor prices, stocks, and storage and processing facilities

CONCLUSION

India's inflation management has successfully moderated core inflation while keeping headline inflation within the RBI's tolerance band. However, food price volatility remains a concern, necessitating stronger supply-side interventions and climate adaptation strategies.

Going forward, India's focus on trade policy reforms, price stabilization mechanisms, and sustainable agricultural practices will play a crucial role in ensuring long-term inflation stability and economic resilience.

Practice Questions

1. Discuss the key drivers of inflation in India and evaluate the effectiveness of monetary and fiscal policies in controlling inflation. (15 Marks)
2. How do global supply chain disruptions impact inflation in India? Suggest measures to mitigate these risks. (10 Marks)

CHAPTER 5: MEDIUM TERM OUTLOOK – DEREGULATION DRIVES GROWTH

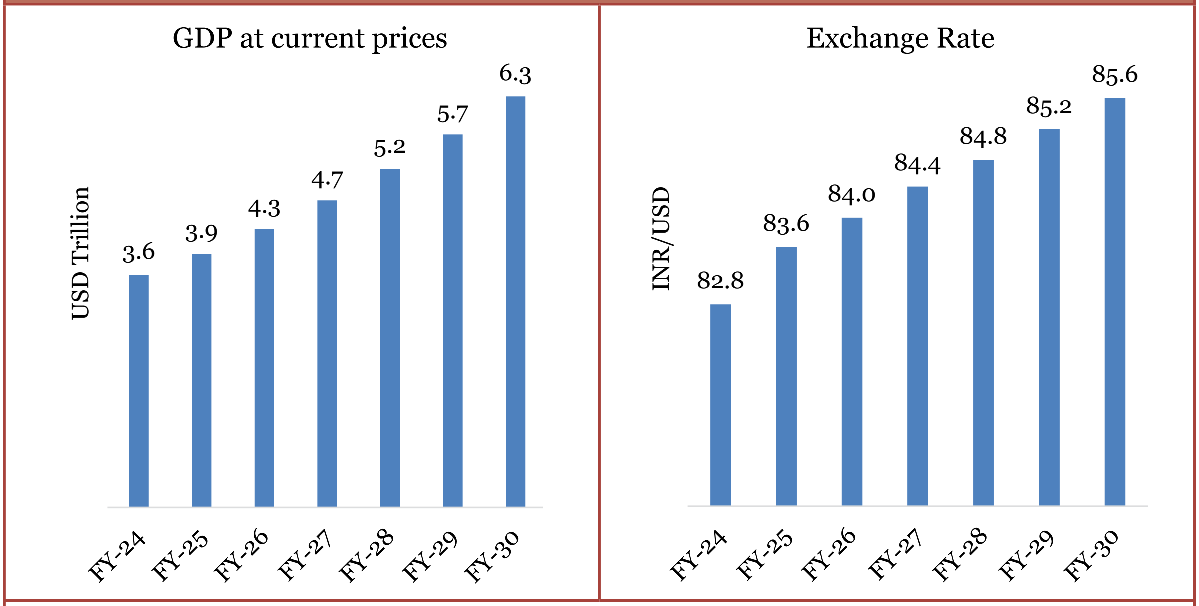
INTRODUCTION

India's medium-term economic trajectory is shaped by structural reforms, investment-led growth, and deregulation. As the global economy undergoes geo-economic fragmentation, climate policy shifts, and trade disruptions, India must focus on domestic demand, financial resilience, and reducing regulatory bottlenecks to sustain high growth.

INDIA'S MEDIUM-TERM OUTLOOK

- India's GDP is projected to grow at 6.5% between FY26 and FY30, backed by:

Chart V.1: IMF WEO India projections from FY25 to FY30



Source: WEO, October 2024

- Strong household consumption growth (supported by rising incomes and employment).
- New private sector investment cycle, particularly in manufacturing, infrastructure, and services.
- Robust government capital expenditure, with a focus on urbanization and connectivity.
- To become Viksit Bharat by 2047, India needs to achieve a growth rate of around 8% at constant prices, on average, for about a decade or two
- The IMF WEO projects India to become a USD 5 trillion economy by FY28 and reach a size of USD 6.307 trillion by FY30

Is it achievable?

- Between FY94 and FY24, India's dollar gross domestic product (GDP) grew at a compounded annual rate of 8.9%.
- In rupee terms, India's nominal GDP grew at a compounded annual rate of 12.4% in the three decades ending FY24.
- So, the IMF expects India to grow at a significantly higher rate of 10.2% in dollar terms and 10.7% in rupee terms in the next five years.

Domestic Demand and Industrial Expansion - Positive Signal

- Private sector capital expenditure (capex) has revived, with fresh investments in semiconductors, AI, electric vehicles, and digital banking.
- The manufacturing sector saw 11.7% growth in FY24, driven by the PLI schemes-backed investments in mobile phones, auto components, and white goods.

- Retail consumption remains strong, supported by a growing middle class and rising digital transactions.
- India's trade elasticity with global GDP has fallen from 2.5x (2008) to 1.1x (2023), emphasizing the need for internal demand-driven growth.
- Infrastructure-led growth (roads, highways, ports) is reducing logistics costs by 10-15%.

GEO-ECONOMIC FRAGMENTATION – THIS TIME MAY BE DIFFERENT

The global economy is once again confronted with the challenge of geo-economic fragmentation (GEF). This time, it is of a scale, scope and complexity that is likely more severe in its impact than what the world witnessed in the early 20th century.

Global Trade Disruptions and Protectionist Policies

Global trade is undergoing a shift, with rising:

- Protectionist trade policies, such as the EU's Carbon Border Adjustment Mechanism (CBAM).
- Supply chain localisation due to U.S. and EU industrial policies.
- Higher tariff barriers and subsidies for domestic industries.

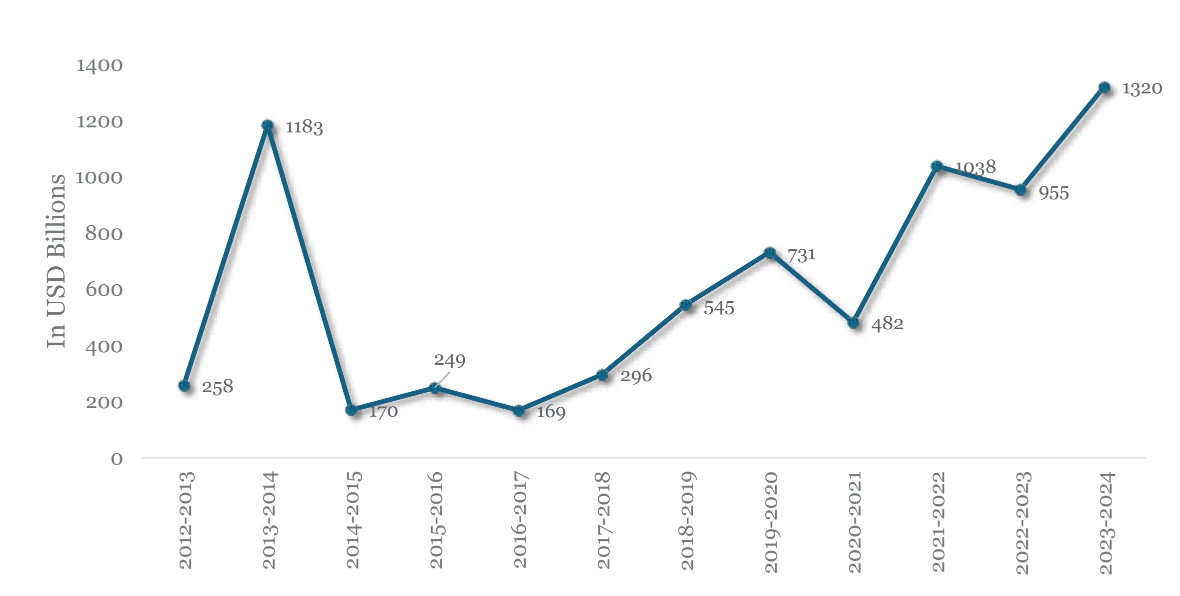
Globalisation since 1980s

- Global population grew from 4.4 billion in 1980 to 8 billion in 2022, with urbanisation rates rising from 39% in 1980 to 57% in 2022
- Global trade accounted for about 39% of world GDP in 1980. By 2012, this share had risen to 60% reflecting the deep integration of global markets.
- Global FDI inflows grew from USD 54 billion in 1980 to over USD 1.5 trillion in 2019
- The global economy grew from USD 11 trillion in 1980 to over USD 100 trillion in 2022 (nominal).
- Extreme poverty rates (those living on less than USD 2.15 a day) fell from 42% of the global population in 1981 to 8.4% in 2019
- In 1980, internet connectivity was virtually non-existent. By 2022, over 5.3 billion people, or 66%of the global population

Growth implications of geo-economic fragmentation

- A sharp rise in the coverage of trade-restrictive measures by WTO members between mid-October 2023 and mid-October 2024
- 169 new trade-restrictive measures introduced between October 2023 and October 2024 are USD 887.7 billion, preceding year the figure stood at USD 337.1 billion
- Trade fragmentation is much more costly this time because, unlike the start of the cold war when goods trade to GDP was 16 per cent, now that ratio is 45 per cent.
- Global FDI flows are increasingly concentrated among geopolitically aligned countries, particularly in strategic sectors.

Chart V.2: Trade coverage of new import-restrictive measures (USD Billion, not cumulative)



- The output losses associated with this FDI relocation emerging from friend-shoring and reshoring are especially severe for emerging markets and developing economies.

India's Response to New Trade Realities

- India is negotiating new Free Trade Agreements (FTAs) with the UK, EU, and Gulf Cooperation Council (GCC) to reduce dependency on any single market.
- PLI schemes have strengthened India's participation in global value chains, particularly in electronics and semiconductors.
- India-Middle East-Europe Economic Corridor (IMEC) will offer alternative routes to global supply chains.
- India's FDI inflows stood at $85 billion in FY24, with top investments in fintech, AI, and renewable energy.
- India's export share in emerging markets has increased by 12%, reducing its dependence on traditional Western economies.

THE ELEPHANT AND THE DRAGON IN THE ROOM

China's role in current global economy

- China's prominent role in global supply chains continues to reshape the economic landscape.
- China is a dominant force in the global manufacturing and energy transition ecosystems.
- It has gained a strategic advantage leveraging its competitiveness and economic policy to play a crucial role in global supply chains of automobile (especially electric vehicles) manufacturing, mining and refining capacity for critical minerals (Copper, Lithium, Nickel, Cobalt, Graphite, etc.) and in clean energy equipment.

India vs. China – Shifting Economic Power

- India's demographic advantage provides a long-term workforce expansion edge over China's aging population.

- China's economic slowdown presents a unique opportunity for India to:
- Attract global supply chains seeking diversification (China+1 strategy).
- Develop labor-intensive industries to absorb manufacturing shifts from China.
- Expand its electronics, semiconductor, and pharmaceutical production capabilities.

India's Increasing Role in Global Trade

- India is strengthening trade with Global South partners (Africa, Latin America) to reduce reliance on traditional markets.
- Investment in logistics and port infrastructure under PM Gati Shakti is positioning India as a key export hub.
- India's exports to China dropped by 8.7% in 2024, while imports remained stable, widening the trade deficit.
- Government incentives are attracting high-tech FDI in AI, cloud computing, and fintech services.

CLIMATE TRANSITION, CHINA, AND GEOPOLITICS

China, the United States, the EU, and other G7 economies produce more than 50 per cent of global greenhouse gas emissions. All have target dates of 2050 to reach net-zero emissions. Trade conflicts between these economies will pose significant risks to the green energy transition, imposing huge costs on the global economy.

China's might in renewable energy landscape

- About 60% of the world's wind installed capacity is sourced from China.
- China also houses nearly 80% of the world's battery manufacturing capacity.
- In 2022 alone, China allocated USD 546 billion towards various investments in solar and wind energy, electric vehicles, and battery technologies vis-à-vis US and EU investments in these sectors, which amounted to USD 321 billion in the same year.
- 70% of the world's rare earth minerals, which are critical resources for high-storage batteries, are processed by Chinese companies

Balancing Growth and Green Energy Goals

- India aims to achieve net-zero emissions by 2070, but the transition presents challenges:
- Dependence on Chinese imports for solar panels, lithium-ion batteries, and EV components.
- High costs of renewable energy transition and infrastructure development.

Investment in Green Hydrogen and Energy Storage:

- PLI schemes are promoting domestic battery production.
- Large-scale investment in solar and wind energy will reduce reliance on fossil fuels.

Energy Security and Climate Finance

- Government incentives for battery manufacturing have led to a 40% reduction in lithium-ion battery costs.

Chart V.7: India's installed capacity mix [2022 v. 2030]

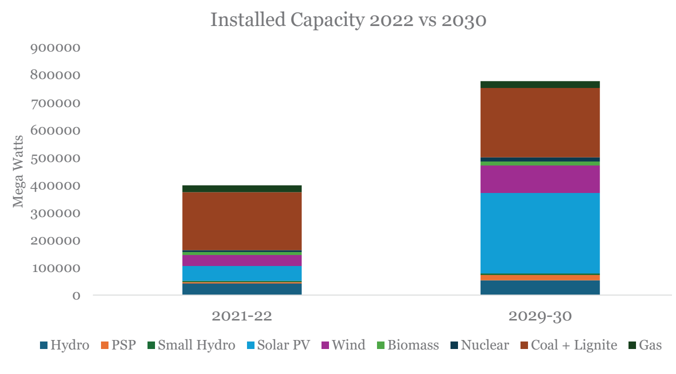
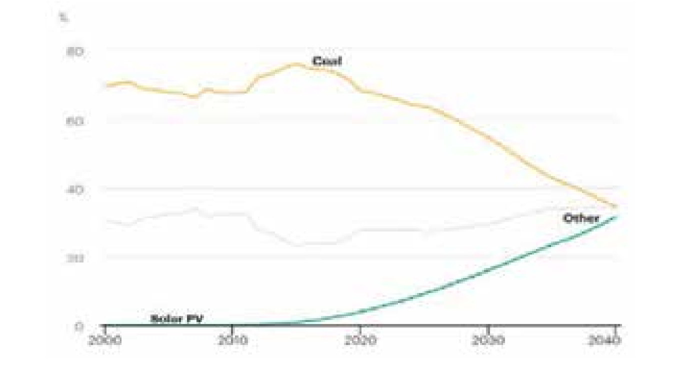


Chart V.8: Change in share of power generation



Source: Report on Optimal Generation Mix 2020 Ver 2.0, Central Electricity Authority, Ministry of Power

- India's renewable energy capacity has surpassed 175 GW, making it the world's third-largest producer.
- PLI incentives in renewables and batteries aims to reduce dependency on Chinese imports.
- Ministry of Mines has analysed the 33 critical minerals vital to India's economic security and found that 24 are currently at high risk of supply disruptions
- PLI Scheme for Advanced Chemistry Cell Manufacturing and the setting up of Khanji Bidesh India Limited (KABIL) have been undertaken to promote climate-tech manufacturing and access to critical minerals
- India's oil import bill declined by 12% due to increased domestic energy production.

IMPLICATIONS FOR INDIA'S GROWTH PROSPECTS

Strengthening Domestic Manufacturing and MSMEs

- India must enhance domestic production of critical components like semiconductors and AI hardware.
- MSMEs need better credit access and integration into global supply chains.

Structural Reforms

- Series of structural reforms in the last decade
- Goods and Services Tax (GST), which has been described as India's EU moment
- Insolvency and Bankruptcy Code (IBC), which established a framework for dealing with corporate renewal
- RERA (Real Estate Regulation Act), which helped clean up the real estate sector
- Jan Vishwas Act 2023 decriminalised 183 provisions in 42 central Acts administered by 19 ministries/ departments.
- Rapid roll-out of digital infrastructure - the India Stack (UID, UPI, DBT)
- India's Digital Public Infrastructure (DPI) has emerged as a game-changer in the country's journey towards a more inclusive and efficient economy

REINVIGORATING THE INTERNAL ENGINES OF GROWTH

Regulatory Bottlenecks in India

- Regulations hurt businesses' ability to start and grow over time. For example, factory regulations make it cheaper for a business to run two 150-worker factories than one 300-worker factory
- Indian workers cannot formally work overtime because the law requires employers to pay at least twice the regular wage. Thus, Indian workers accept informal employment to receive overtime pay.
- Indians cannot undertake apprenticeships while undergoing formal education due to working hour limits on apprentices, thus discouraging innovation and creative destruction
- Indian firms cannot deploy more labour hours during peak seasons and lower them during lean seasons
- Commercial premises and factory land have to leave high-value land as setbacks to comply with building bye laws, forgoing opportunity to create more jobs by using full land area efficiently

Table V.1: List of areas of regulation and provisions affecting businesses

Area	Examples of regulations
Legal Status and admin	Municipal laws, citizen charters, accountability in public service delivery
Land	Land revenue, land reform, town and country planning, land ceiling
Building and Construction	Town and country planning, building bye-laws, fire safety laws
Labour	Rules under Union Codes, factories, contract labour, shops laws
Utilities	Water, electricity, building bye-laws, municipal laws
Transport	Motor vehicles laws, motor transport workers laws, carriage of goods
Logistics	Warehousing and logistics policies, building bye-laws
Buying and Selling	Agricultural Produce and Livestock Market Committee laws
Environment	Laws for prevention and control of pollution of water, air
Sector Specific	Excise, food safety, legal metrology

Deregulation as a Key Growth Enabler

Recent regulatory reforms include:

- Simplifying land acquisition and labour laws.
- Reducing bureaucratic compliance burdens for startups and MSMEs.
- Decriminalisation of minor economic offenses to encourage business activity.

Enhancing Business Confidence and Governance

- GST reforms and tax simplification have improved the ease of doing business.

- Faster dispute resolution mechanisms and contract enforcement will boost investor confidence.
- States that ranked higher in "Ease of Doing Business" attracted 20% more industrial investment.
- Many states have set targets of becoming billion to trillion-dollar economies over the next two decades
- GST compliance reforms saved businesses ₹12,000 crore annually in administrative costs.

Making a case for Ease of Doing Business 2.0

- Removing prohibitions on women from working in factory processes
- Rationalise parking norms to reduce land loss in industrial and commercial plots
- Adding safeguards to reduce chances of arbitrary administrative action
- Reducing electricity tariff markup for industrial users along with cross subsidisation
- Increasing the role of private parties in building approvals and inspections
- Increasing the validity of fire NOC for low- and moderate-risk buildings

Approach to reform	Description	Status
Reduce compliance burden	Reduce administrative costs incurred by businesses to demonstrate adherence to laws.	Already pursued in Phase 1 of EoDB
Streamline systems, processes and information	Modify processes for business-government interactions to remove redundancies, simplify process flow, and increase transparency and accountability of government services.	
Digitise systems, processes and information	Establish digital means of interacting with businesses to improve efficiency.	
Provide incentives	Extend special benefits to key sectors or clusters of businesses.	
Liberalise standards and controls	Minimise controls that distort markets, adopt a 'minimum necessary, maximum feasible' approach to setting regulations	This may be pursued in Phase 2 of EoDB
Set legal safeguards for enforcement	Ensure adherence to due process norms to encourage a facts-based resolution of disputes	
Reduce tariffs and fees	Minimise or remove mandated charges inflating utility costs	
Use risk-based regulation	Tailor legal norms to the risk profile of businesses, involve third parties in enforcement	

CONCLUSION

Complementing the efforts of the Centre, States must pursue systematic deregulation as a policy priority so that economic freedom of factors of production is augmented. The call for enhancing economic freedom through deregulation has renewed momentum in today's rapidly evolving global economy. Over-regulation stifles innovation and economic dynamism. To reach its $5 trillion economy goal, India must accelerate structural reforms, attract long-term FDI, and strengthen climate resilience while ensuring sustainable industrial expansion.

Practice Questions

1. Discuss the role of infrastructure and financial reforms in shaping India's medium-term economic outlook. (10 Marks)
2. Critically analyse how deregulation can enhance India's economic growth. What challenges must be addressed to ensure balanced development? (15 Marks)

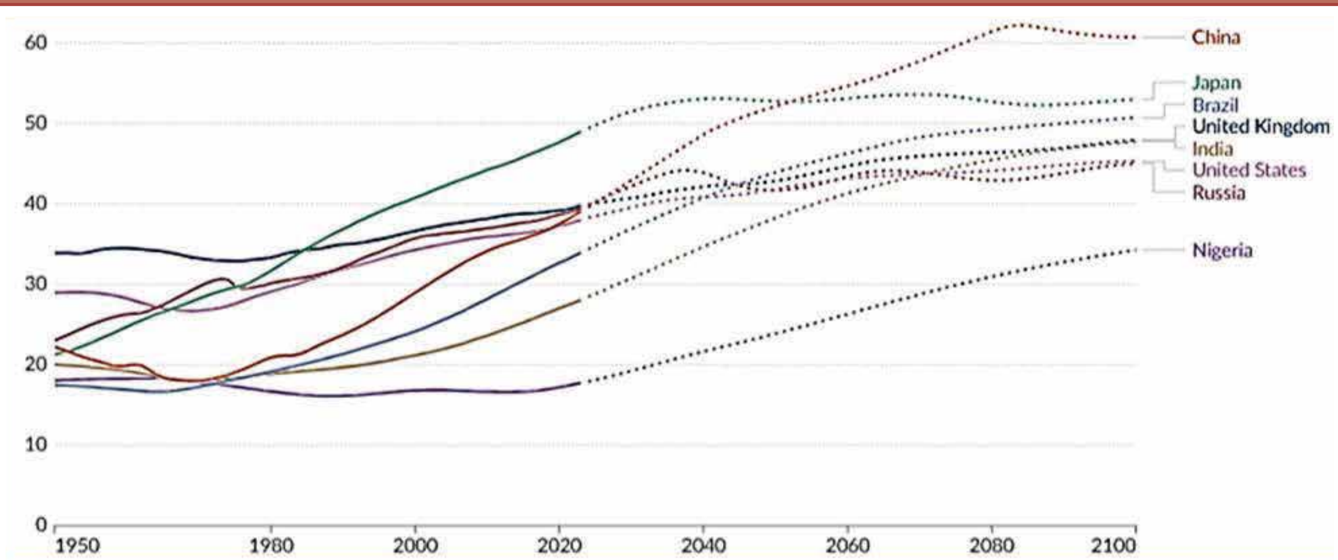
CHAPTER 12: EMPLOYMENT AND SKILL DEVELOPMENT – EXISTENTIAL PRIORITIES

INTRODUCTION

Employment and skill development are critical for India's economic resilience and social stability. As the crucial link between growth and prosperity, the quantity and quality of employment in an economy determines how economic growth sustainably percolates the masses. India will have a growing working-age population and healthy manufacturing sector by 2030.

Demography-related statistics

Chart XII.1: Median Age across countries showing India's relatively younger population



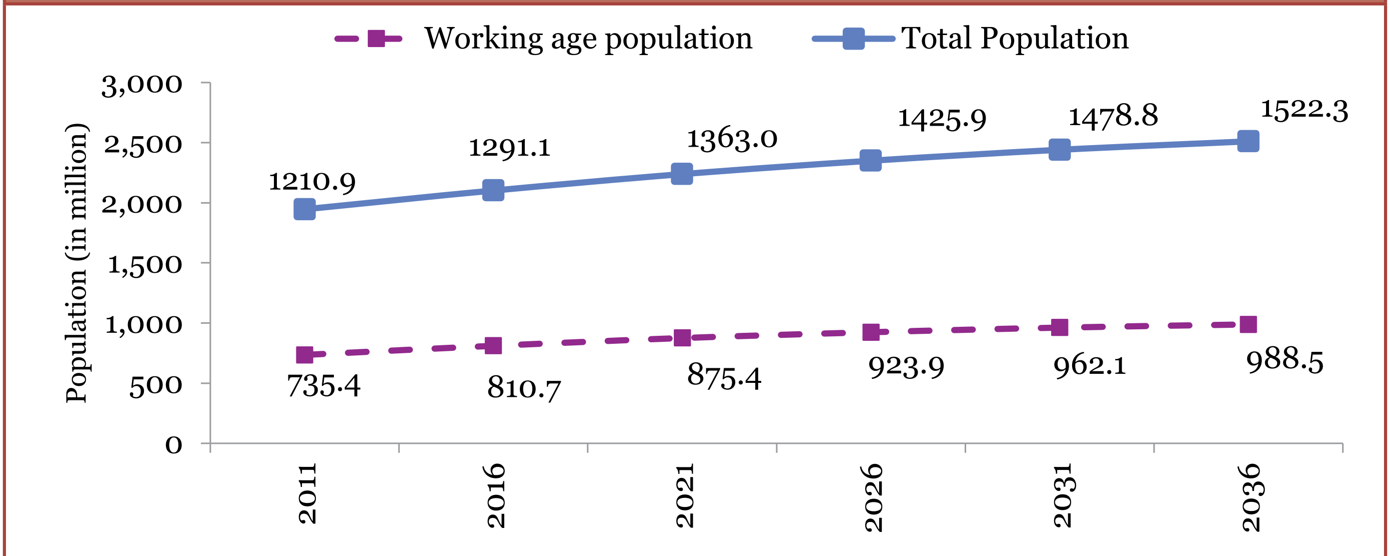
Source: UN World Population Prospects, 2024

- India currently has a young population, with a median age of around 28 years, compared to the ageing population of developed countries.
- The total dependency ratio has declined from 64.6% in 2011 to 55.7 per cent in 2021 and is projected to fall further to 54.3% by 2026.
- The Indian economy must generate, on average, 78.5 lakh non-farm jobs annually until 2030 to productively engage its growing working population

STATE OF EMPLOYMENT

Labor Force Participation and Workforce Growth

Chart XII.3: Estimated number of people in the working age group and total population



Source: Report of the Technical Group on Population Projections for India and States 2011-2036, Ministry of Health & Family Welfare (MoHFW), July, 2020

- LFPR increased from 49.3% to 50.4% during Q2 of FY24 to Q2 FY25
- The WPR rose from 46% to 47.2% during the same period
- The unemployment rate (UR) in the Usual Status (US) has declined from 6% in 2017-18 to 3.2% in 2023-24.
- Youth employment (ages 15-29) remains a concern, requiring targeted skilling programs.
- Female labor force participation (FLFP) increased to 32.8%, driven by employment shifts in services and digital platforms.

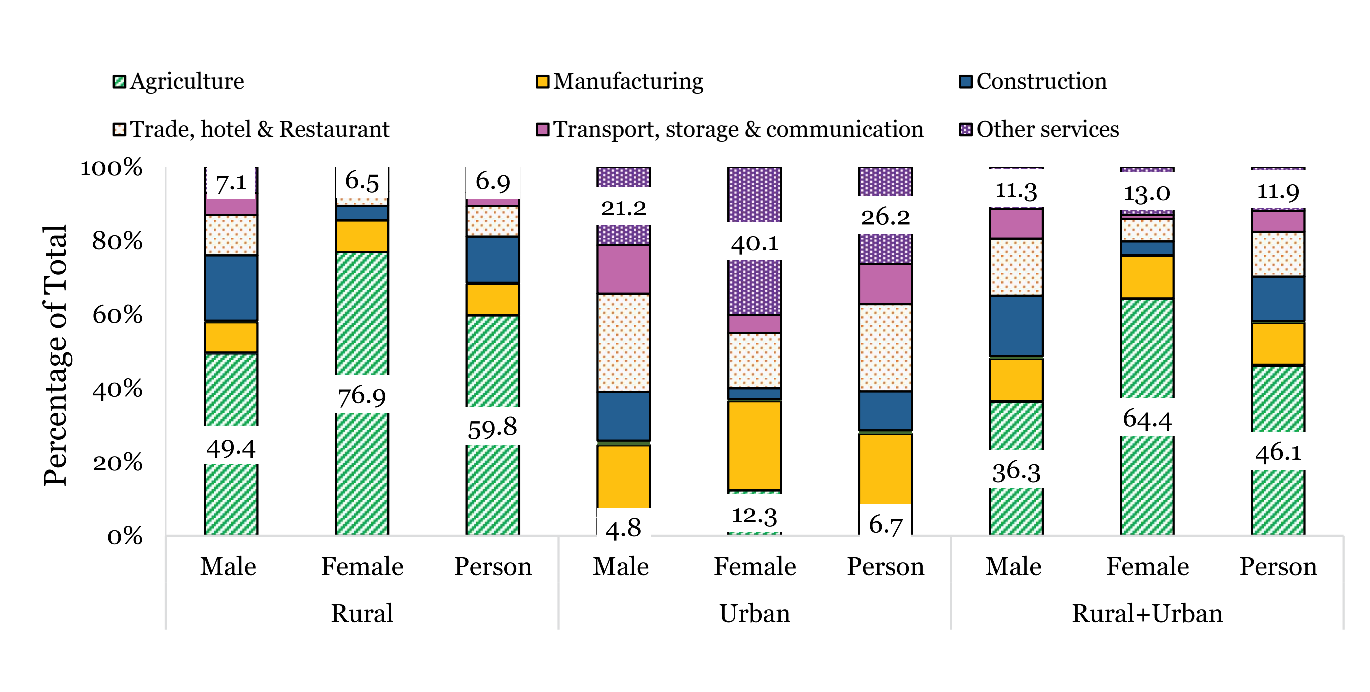
Occupational Structure in India

- The proportion of self-employed workers in the workforce has risen from 52.2% in 2017-18 to 58.4% in 2023-24.
- The share of workers in regular/salaried jobs decreased from 22.8% to 21.7% during the same period
- The decline in casual workers, from 24.9% to 19.8%, also indicates a shift toward more structured forms of self-employment.

Gender-based Scenario

The proportion of women in regular wage/salaried employment decreased, more women engage in self-employment or contribute to household enterprises, especially in rural areas.

Chart XII.8 (a) Distribution of workers by broad industry division in 2023-24



Sector-Wise Employment Distribution

- **Agriculture:** Its share rising from 44.1% in 2017-18 to 46.1% in 2023-24.
- **Manufacturing:** Falling from 12.1% to 11.4%
- **Services:** Falling from 31.1% to 29.7% during the same period

(Rest in the construction and mining sector)

Female in Labour Force

- The female labour force participation rate (FLFPR) has been rising for seven years, i.e., from 23.3% in 2017-18 to 41.7% in 2023-24, driven mainly by the rising participation of rural women.
- About 50% of Government-recognised startups (1,50,000 approx.) have least one woman director

Women Entrepreneurship

- A recent World Bank paper (Gupta et al., 2024) highlights that promoting women-owned, growth-oriented enterprises could significantly boost FLFPR and economic growth in rural India.
- Out of the total workforce engaged in the handicrafts sector, an estimated 56% are women.

Formalisation of Enterprises[31]

63 per cent of the 2.41 crore enterprises formalised since January 2023 are women-owned.

Marketing Support[32]

Women's trade fair participation is fully subsidised.

PM Employment Guarantee Programme[33]

41 per cent of loans in FY24 were sanctioned to women, with higher subsidies (25–35 per cent) and lower contributions (5 per cent).

Procurement

3 per cent of procurement by CPSEs is reserved for women-owned enterprises.

Skill Development

Over 21,600 women trained in coir manufacturing in 5 years; free entrepreneurial training is offered.

ZED Certification[34]

100 per cent subsidy on certification for women MSMEs.

Access to Credit[35]

Women entrepreneurs receive 90 per cent guarantees (vs. 75 per cent for others) and reduced fees under the Credit Guarantee Scheme.

Of 97.68 lakh guarantees approved, 22 per cent are for women.

Department for Promotion of Industry and Internal Trade

Start-up Support[37]

10 per cent of the Fund of Funds for Start-ups is reserved for women.

Women Entrepreneurship Platform[38]

Launched in 2018 to aggregate and showcase policies, with NSA awards recognizing women-led start-ups.

Ministry of Food Processing Industries

PM Micro Food Processing Scheme[39]

SHG members receive ₹40,000 seed capital and 50 per cent branding/marketing grants.

Ministry of Tribal Affairs

Adivasi Mahila Sashaktikaran Yojana[40]

Loans up to ₹2 lakh at 4 per cent interest for ST women.

Ministry of Cooperation[41]

NCDC Support[42]

₹6,426 crore disbursed for women cooperatives; 25,385 registered cooperatives.

Nandini Sahakar Scheme

2 per cent interest subvention for innovative cooperative projects.

Swayam Shakti Sahakar Yojna

Working capital loan to support women SHGs.

Issues

As the size of the enterprise increases from micro to small and then to medium, women's share in ownership drops from 22% to 12%and further to 7%, respectively.

Other challenges

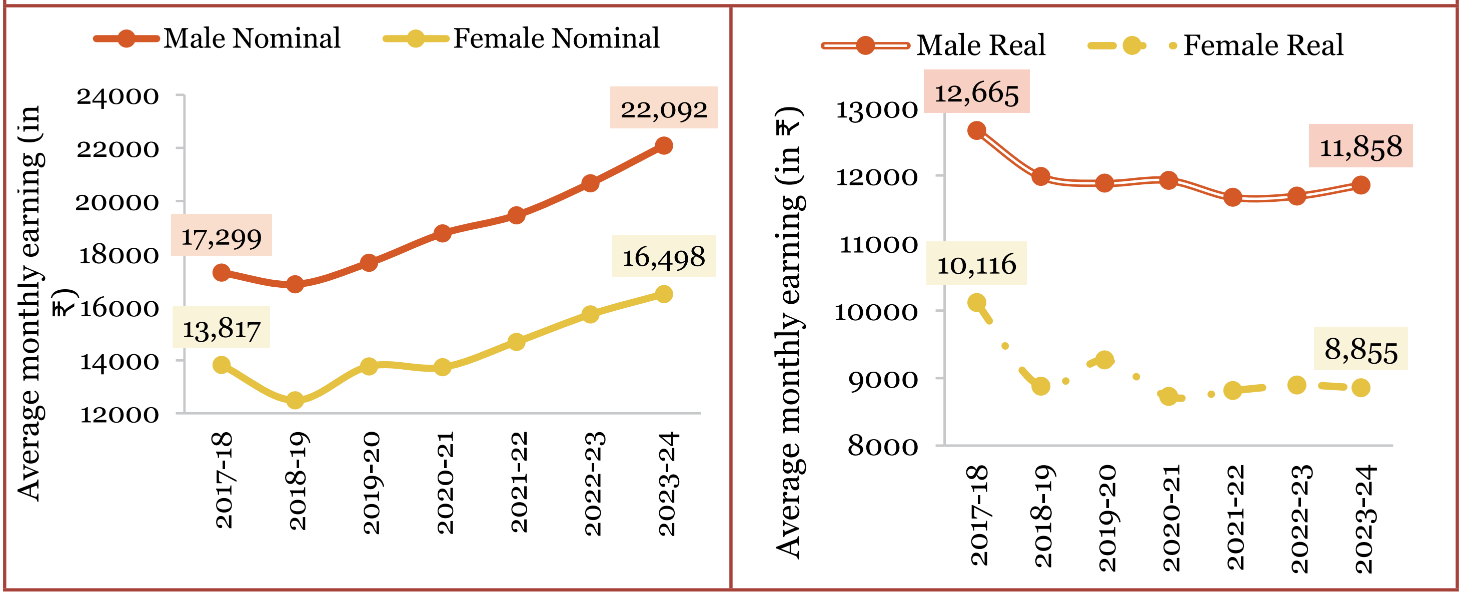
- Limited business skills
- Market access
- Technology gaps
- Lack of mentorship and networking

Trends in wages and earnings

- Nominal wages have shown good growth across all categories, outpacing growth in real wages.

Chart XII.10 Male and female earnings

Chart XII.10 (a) Nominal and real regular wage/ salaried employment[53]

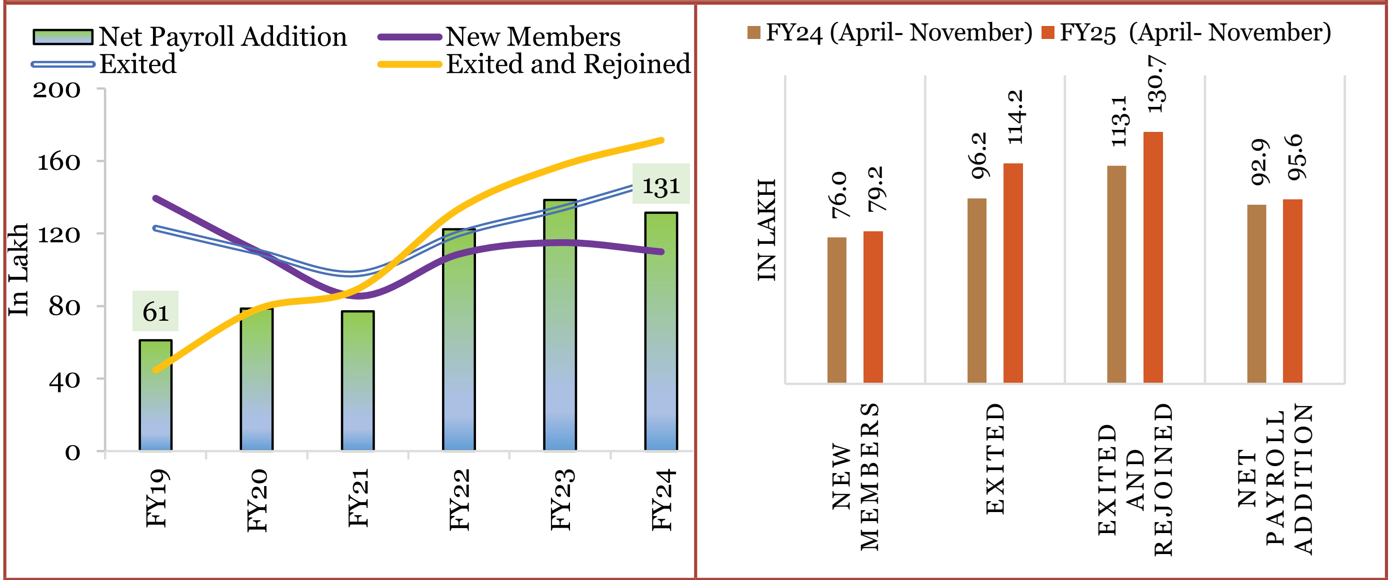


- The real wage rate in agriculture demonstrated modest growth
- The average emolument per hired worker in unincorporated enterprises rose by 13% in 2023- 24 compared to 2022-23.
- Corporate profitability soared to a 15-year peak in FY24 with profit-to-GDP ratio surging from 2.1%in FY03 to 4.8% in FY24, the highest since FY08. However, while profits surged, wages lagged.

Employment trends

- As per the Annual Survey of Industries (ASI) results for FY23, more than 7% increase in employment over the previous year.

Chart XII.16: Net addition of subscribers in the EPFO (in lakh)



Source: EPFO
Note: Net addition in payroll = No. of new subscribers + No. of exited members who re-joined – No. of members exited

- In terms of the share of employment, large factories continue to employ about 80% of the total workers
- Formal Sector: Net additions to EPFO subscriptions have more than doubled, rising from 61 lakh in FY19 to 131 lakhs in FY24.
- Informal Sector: As of 31 December 2024, over 30.51 crore unorganised workers have already registered on the eShram portal.

JOB CREATION: ACTION TOWARDS ENHANCED EMPLOYMENT OPPORTUNITIES

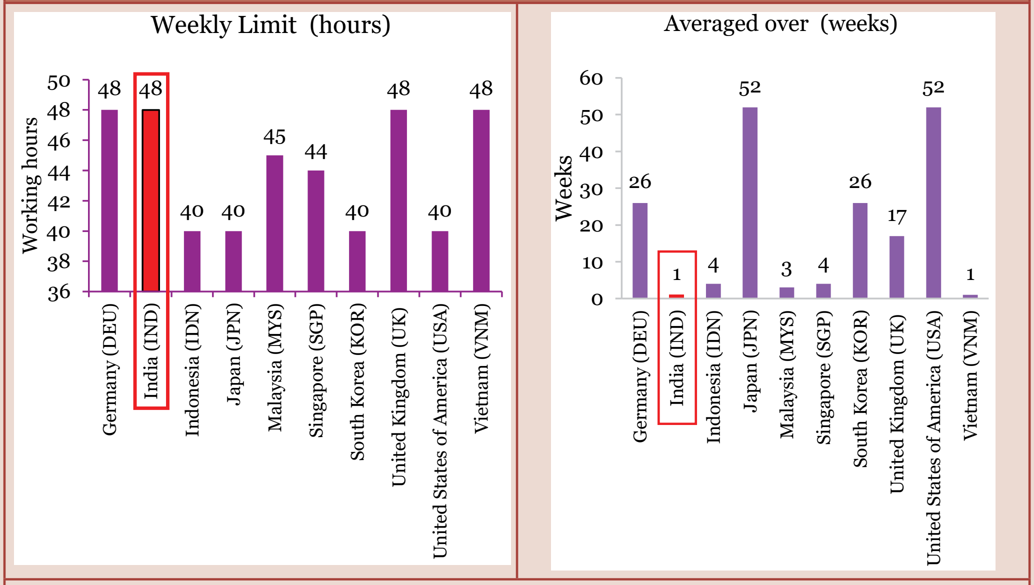
Emerging Employment Sectors

- Digital and IT Services: India's IT sector employs 5.1 million workers, contributing 8% to GDP. Expansion in AI, cloud computing, and cybersecurity are driving high-skill job creation.
- Green Jobs & Renewable Energy: 1 million+ new jobs expected in solar, wind, and green hydrogen sectors by 2030.
- Healthcare & EdTech: Healthcare workforce is expected to grow by 15% over the next five years, driven by telemedicine and digital health expansion.

Employment opportunities through the digital economy

Gig Economy & E-Commerce: Delivery and logistics workforce increased by 22% YoY, with rising demand for last-mile connectivity. According to NITI Aayog, the gig workforce is projected to reach 23.5 crore by 2029-30, comprising 6.7% of the non-agricultural workforce and 4.1% of total livelihoods

Chart XII.18: Cap on average weekly working hours across some countries



Source: Country-specific laws and regulations[81]

SKILL DEVELOPMENT: UPSKILLING, RESKILLING AND NEW SKILLING FOR A CHANGING WORLD

Government-Led Skilling Initiatives

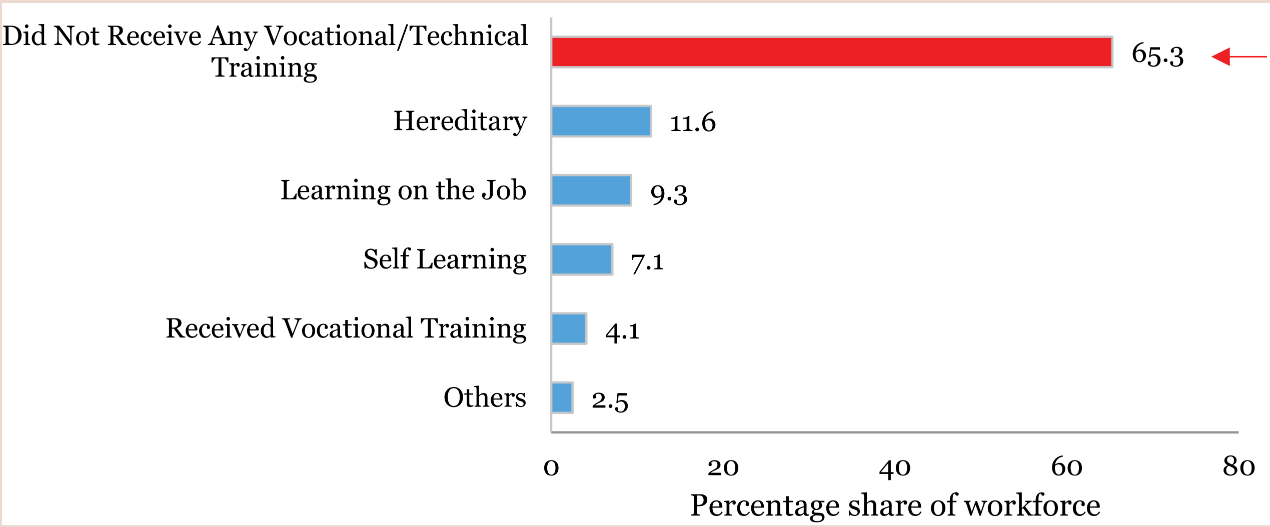
- **Skill India Mission:** Over 10 million youth trained across various domains since inception.
- **PM Kaushal Vikas Yojana (PMKVY):** 7.6 million beneficiaries trained in high-demand skills in FY24. Focus on AI, robotics, and digital marketing to enhance employability.
- **National Apprenticeship Promotion Scheme (NAPS):** Apprenticeship enrollments crossed 1.5 million, linking education to industry needs.

Tiered skill framework

Chart XII.24: Skills Pyramid: Tiered framework for AI upskilling, reskilling and new skilling

- Policies should focus less on skilling for "AI jobs" and more on understanding how AI affects different tasks.
- There should be focus on re-skilling and up-skilling for AI jobs and roles or training on the use of AI.
- The skilling strategy needs to adopt a layered approach to address diverse industry demands and workforce needs effectively.

Chart XII.22: Status of vocational training in India for 2023-24 (age group 15-59 years)



Source: Annual PLFS report 2023-24. MoSPI

Internship as skilling strategy

- Internships are mutually beneficial arrangements between young aspirants and employers.
- Internships hone communication, collaboration, creativity, and critical thinking.
- Along with internships, a public-private partnership for skill development and vocational training is another effective way of creating an industry-ready workforce.

PM Internship Scheme

- Internships in 500 top companies to one crore youth over a period of five years.
- 12-month paid internship opportunities with top companies of India offered to those aged 21-24 years
- Monthly stipend of ₹5000, funded jointly by the government (₹4500) and the company (₹500), with an additional ₹6000 for incidentals.

International mobility of skilled workers

- India has a diaspora population of 32 million
- There is likely to be a demand for 97 million new jobs worldwide by 2025 in sectors such as healthcare, construction, IT, agriculture, and financial services.
- India's demographic dividend makes it a global talent hub, provided it can cultivate a workforce with employable, industry-relevant skills.

CONCLUSION

India has seen good growth in employment in recent years, as highlighted by labour market indicators that show strong signs of post-pandemic recovery and increased formalisation of the economy. By simplifying compliance, fostering labour flexibility, and promoting worker welfare, labour reforms have created an enabling environment that balances ease of doing business with the protection of worker rights. With targeted reforms and workforce modernization, India can leverage its demographic dividend to become a global leader in high-value job creation and digital employment.

Practice Questions

1. Examine the role of labour market reforms in enhancing formal employment in India. What more needs to be done to improve workforce participation? (10 Marks)
2. How can India effectively leverage its demographic dividend to boost employment opportunities? Discuss with reference to recent policy initiatives. (15 Marks)

CHAPTER 13: LABOUR IN THE AI ERA: CRISIS OR CATALYST?

INTRODUCTION

Concerns and fears about Artificial Intelligence (AI) disrupting labour markets have intensified as developments in the field have continually demonstrated rapid progress over the last four years. Artificial Intelligence (AI) is redefining the global labour market, sparking debates on whether it will be a job destroyer or a productivity enhancer. The impact of AI on the labour market, particularly entry-level jobs, is turning into a point of concern for policymakers. While automation and AI-driven processes may displace certain jobs, they also have the potential to create new roles, enhance worker productivity, and drive economic transformation. OpenAI has initiated an 'arms race' in AI between 2022 and 2024. The number of AI patents granted globally increased 62.7% to over 62,000 between 2021 and 2022. The annual global private investments in Generative AI surged from approximately USD 3 billion in 2022 to USD 25.2 billion by the end of 2023.

REVOLUTION AND RIPPLES

AI's Transformative Impact on Work

- Automation and AI integration are reshaping traditional job roles across industries.
- White-collar jobs in areas like finance, healthcare, and customer service are increasingly being augmented or replaced by AI.
- Blue-collar sectors such as manufacturing and logistics are witnessing robotic process automation, reducing dependency on manual labour.

Damaging impact by any technological disruption

- In the pursuit of productivity and profits, the substitution of labour for capital has resulted in widespread economic hardship, damaging social cohesion.
- Many struggle to find jobs which results in income inequality. Those who adapted to new technological demands saw their wages increase, while others experienced declining pay and fewer opportunities.

The Global AI Labour Disruption

- The World Economic Forum (WEF) estimates AI will replace 85 million jobs globally by 2025 but will also create 97 million new jobs.
- AI-driven automation is expected to impact up to 40% of global jobs within the next two decades.
- A study by the Bank for International Settlements finds that 45 per cent of the jobs in the upper quartile of the wage distribution remain exposed to AI in the United States.
- Goldman Sachs economists state that nearly 300 million full-time jobs remain exposed to AI-driven automation.

Job losses-Potential Implications for India

- Protracted labour displacement is something that a labour-surplus country like India cannot afford.
- India is a majorly services driven economy, with a significant share of the I.T. workforce employed in low value-added services
- India is also a consumption-based economy, thus the fall in consumption that can result from the displacement of its workforce is bound to have macroeconomic implications

THE NEED FOR ROBUST INSTITUTIONS

Types of Institutions (For absorbing technological disruptions)

- **Enabling Institutions:** They are focused on equipping the workforce with the necessary skills needed to adapt and thrive in a shifting landscape. As new auxiliary tasks and sectors emerge from the widespread adoption of technology, enabling institutions facilitate the smooth transition of the workforce to these new jobs, reducing the damage to worker income and preventing loss of employability.
- **Insuring Institutions:** They intend to provide a soft-landing for workers whose finances have been hit and whose well-being has been affected during the transitionary period. These institutions help secure a standard of living during the shift, keep inequalities in check and aid in keeping the social fabric cohesive.
- **Stewarding Institutions (Proposed by Economic Survey 2024-25):** These institutions would be agile, cross cutting across sectors and up to date on the latest developments, so that they are equipped to identify both opportunities and threats. They are also required for fostering the social acceptability of AI by promoting the right levels of transparency and accountability in AI applications.

Building A Suitable Institution for India

- AI presently is in its infancy stage, irrespective of its income level. Thus, it is on equal footing as far as discovering its applicability goes.
- This level playing field provides India the time to build the necessary institutions that will minimise the disruptions and maximise societal benefits.
- There is a reasonable time for India to overcome several obstacles related to general adoption of AI

VISION TO VIABILITY: AI'S REAL-WORLD CHALLENGES

Differentiating between Breakthrough and Practicality

- Large Language Models are capable of acing exams and achieving high test scores, but the field is still far from having a model come up with original, publishable research.
- At its current stage of development, AI is more experimental as it is still finding its footing. Thus, its real world utility is still unclear.

- It is known to 'hallucinate' and generate outputs that are not based on what is true but rather on what is the best fit for the question.

Reliability challenges

- There is a higher error rate, which limits LLM's deployment in businesses and real-world complex
- Applications like path planning algorithms for an autonomous vehicle.
- In one instance, a self-driving car fatally struck a pedestrian on a four-lane road because it failed to recognize the individual as a pedestrian, as the person was not near a crosswalk.
- Application of AI in recruitment turned out to prefer male candidates over female applicants due to the larger number of males in its training sample.
- The introduction of AI further distances humans from ethical responsibilities traditionally tied to decision-making, potentially exacerbating a lack of accountability.

The Infrastructure Challenge

- Once technology had proven its practicality (more than its reliability, as reliability would be fine-tuned with subsequent iterations of the technology), infrastructure creation naturally followed.
- For example:
- The Industrial Revolution succeeded due to development in canals, waterways, and roads
- The expansion of the electricity grid provided households with access to power, thus fuelling the demand for home appliances and leading to the era of mass production.
- The age of the automobile has gained momentum due to the construction of roads and highways
- The proliferation of computers and infrastructure created for telecommunications gave impetus to the adoption of the Internet.

For AI to be Successful

- The development of AI is going to depend on the availability of quality infrastructure and the pace of its creation
- A holistic infrastructure that combines technological resources, human expertise, and organisational readiness is needed.

Resource Challenges

- Performance gains through adoption of AI must be coupled with significant reductions in costs and more efficient utilisation of scarce resources
- High energy consumption of data centres
- Increased cooling needs of semiconductor hardwares may risk water availability
- Need for vast area of land for data centres can drive up land prices
- Need for constant supply of critical minerals can create competition challenges

AI AND INDIA: ARE THERE OPPORTUNITIES?

AI as a Growth Catalyst for India

- Demand for AI perfectly resonates deeply with India's unique demographic and economic landscape.

- India's predominantly services-driven economy, coupled with its young and dynamic population, offers a perfect opportunity, only if proactively and carefully managed.
- AI can enhance India's economic productivity, boost efficiency in service delivery, and drive GDP growth.
- India's digital economy, projected to reach $1 trillion by 2030, will heavily rely on AI-driven innovations.
- AI-driven automation in agriculture, healthcare, and governance can significantly enhance service efficiency.

THE LABOUR MARKET EVOLUTION

Labour and Technology, when integrated in the right way, have complemented one another rather than being substitutes. It has been found that productivity gains due to automation led to robust job growth and higher earnings for workers over the course of nearly four decades before plateauing.

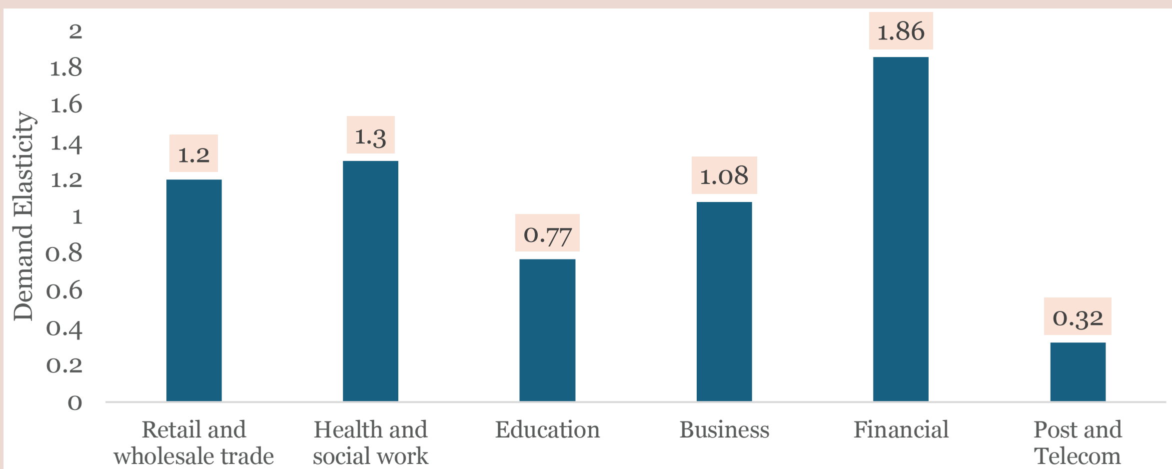
AI's Impact on Workforce Structures

- Traditional hierarchical workforce models are evolving into AI-augmented hybrid structures.
- Gig and remote work opportunities are increasing, fueled by AI-driven digital platforms.
- AI-enhanced productivity may lead to shorter workweeks, reducing worker burnout.
- In more complex fields such as scientific research, Human-AI teams are able to generate high-quality output by capitalising on the best of human and machine intelligence.
- Increase in quality of skill sets for low-skilled workforce, leading to productivity gains in the economy.
- Supplementing human decision-making with AI assistants may help in maximising the micro- and macroeconomic benefits of technology.

AUGMENTING INDIA'S SERVICES SECTOR

- India is a services-driven economy, and the opportunities for enhancing the productivity of the workforce are ample.
- Education and skilling are going to play a critical role in driving the success of human-centric AI adoption in the country while minimising labour displacement.
- Skills such as critical thinking, higher degrees of creativity, and the capacity for more specialised knowledge may well be the new normal.

Chart XIII.1: Demand Elasticities across services sectors for India



Source: Author's estimates

While initial displacement is to be expected for workers who fail to catch up to the market demands, the magnitude of displacement also depends on how displacement and productivity effects weigh against each other.

AI's Role in Strengthening India's Services Industry

- India's IT and BPO industries are early adopters of AI-driven automation.
- AI-powered solutions are enhancing customer experience, fraud detection, and business intelligence.

AI Integration in Healthcare and Financial Services

- Healthcare: AI-driven diagnostics and telemedicine are improving patient care.
- Finance: AI-powered risk assessment and automated financial advisory services are revolutionizing banking.

CONCLUSION

India's approach to AI-driven labour market evolution should be a balance of innovation and inclusivity. AI should augment, not replace, human workers, with a focus on job transition programs. Government and industry collaboration is essential to build an AI-ready workforce. Policymakers should ask themselves, "What were the problems in the world that demanded AI as the answer?" In other words, is AI a solution in search of a problem? A tripartite compact between the government, private sector and academia can ensure that the gains from AI-driven productivity are widely distributed, taking us in the direction of the ideal inclusive growth strategy

Practice Questions

1. Examine the impact of AI on India's workforce. What policy measures are required to balance technological advancement with labour security? (10 Marks)
2. Artificial Intelligence (AI) is transforming the labour market globally. Discuss how India can maximize AI-driven employment opportunities while mitigating job displacement risks. (15 Marks)

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Total Fee: Rs. 1100/-
Per Module Fee: Rs. 500/-

For Lukmaan AIPMT Qualified Students, any other Lukmaan Ex-Students
Rs. 900/-

For Lukmaan Ex- Foundation Students
Rs. 700/-

Special Concession*for Foundation & AIPMT Students

Top Rankers Since 2011: 01, 02, 03, 05, 07, 08, 09, 10